Company Focus

SMALL & MID CAP

6 January 2009 | 14 pages

Housing Development and Infrastructure (HDIL.BO)

Initiation of coverage

Initiate at Sell: High Risk-Reward Model; TDR Prices/Absorption a Concern

- **Initiate at Sell, TP Rs118** — HDIL is a slum rehab specialist. We initiate at Sell/High Risk with a Rs118 target price, based on a 40% discount (factoring HDIL's high risk-reward model) to our NAV of Rs196. With high downside risk to TDR/asset prices, absorption issues in Mumbai (its domain market) given the slowdown and the stock up 61% in the last one month, we see downside risks.
- **High risk-reward model** — HDIL's thrust and expertise in slum rehab projects (57% of Gross NAV) provide it with a large development opportunity that is profitable, but this high risk-reward model is not favored in a downturn.
- **Mumbai airport project a big win; risks remain** — The airport project will provide HDIL with visibility and contribute Rs85/share (46% of Gross NAV). While Phase I execution is encouraging, we see correction in TDR prices/rentals, slackening demand in Mumbai and delays adversely affecting company earnings.
- **Weak outlook for Mumbai a dampener** — With 89% of Gross NAV contributed by Mumbai in mostly suburban areas, we see concentration risk for HDIL. While we build in a 25% price decline factoring higher price risks, volatile capital markets and deteriorating news on leasing activity will dampen stock sentiment.
- **Risks outweigh positives** — With increasing risk to TDR prices/absorption (15% of Gross NAV), slackening office demand, likely execution delays in the airport project resulting in penalties, tight liquidity crunch and the stock at a 27% discount to NAV versus our target of 40%, we believe risks outweigh positives.

Sell/High Risk	3H
Price (05 Jan 09)	Rs142.35
Target price	Rs118.00
Expected share price return	-17.1%
Expected dividend yield	1.8%
Expected total return	**-15.3%**
Market Cap	Rs39,216M
	US$810M

Price Performance (RIC: HDIL.BO, BB: HDIL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	5,480	22.72	367.2	6.3	4.7	119.0	0.0
2008A	14,099	51.18	125.3	2.8	1.1	64.4	2.1
2009E	10,210	37.06	-27.6	3.8	0.9	24.8	1.8
2010E	8,140	29.55	-20.3	4.8	0.7	16.4	1.8
2011E	8,956	32.51	10.0	4.4	0.6	15.6	1.8

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	6.3	2.8	3.8	4.8	4.4
P/E reported (x)	6.3	2.8	3.8	4.8	4.4
P/BV (x)	4.7	1.1	0.9	0.7	0.6
Dividend yield (%)	0.0	2.1	1.8	1.8	1.8
Per Share Data (Rs)					
EPS adjusted	22.72	51.18	37.06	29.55	32.51
EPS reported	22.72	51.18	37.06	29.55	32.51
BVPS	30.44	132.18	166.74	193.79	223.80
NAVps ordinary	na	na	na	na	na
DPS	0.00	3.00	2.50	2.50	2.50
Profit & Loss (RsM)					
Net operating income (NOI)	**6,831**	**17,352**	**14,756**	**12,934**	**15,078**
G&A expenses	-211	-431	-730	-965	-1,158
Other Operating items	-13	-22	-50	-58	-66
EBIT including associates	**6,606**	**16,899**	**13,976**	**11,912**	**13,854**
Non-oper./net int./except.	-355	-878	-2,307	-2,609	-3,619
Pre-tax profit	**6,251**	**16,021**	**11,669**	**9,303**	**10,235**
Tax	-771	-1,922	-1,459	-1,163	-1,279
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Reported net income	**5,480**	**14,099**	**10,210**	**8,140**	**8,956**
Adjusted earnings	5,480	14,099	10,210	8,140	8,956
Adjusted EBIT	6,606	16,899	13,976	11,912	13,854
Adjusted EBITDA	6,620	16,921	14,026	11,969	13,920
Growth Rates (%)					
NOI	377.8	154.0	-15.0	-12.3	16.6
EBIT adjusted	394.8	155.8	-17.3	-14.8	16.3
EPS adjusted	367.2	125.3	-27.6	-20.3	10.0
Cash Flow (RsM)					
Operating cash flow	**-1,328**	**-39,526**	**-15,849**	**-10,678**	**-12,820**
Depreciation/amortization	13	22	50	58	66
Net working capital	-7,374	-53,449	-26,133	-18,875	-21,842
Investing cash flow	**-614**	**-265**	**-249**	**-273**	**-300**
Capital expenditure	-98	-455	-58	-63	-69
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,559**	**43,233**	**16,344**	**10,234**	**13,511**
Borrowings	1,737	27,327	17,033	10,923	14,200
Dividends paid	0	-491	-689	-689	-689
Change in cash	**-383**	**3,443**	**246**	**-717**	**391**
Balance Sheet (RsM)					
Total assets	**19,696**	**75,034**	**104,132**	**122,484**	**146,637**
Cash & cash equivalent	57	3,505	3,751	3,034	3,425
Net fixed assets	254	596	604	609	612
Total liabilities	**12,354**	**38,619**	**58,196**	**69,096**	**84,983**
Total Debt	3,757	31,127	48,160	59,083	73,283
Shareholders' funds	**7,342**	**36,415**	**45,936**	**53,388**	**61,655**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	54.9	71.0	56.5	53.9	50.2
ROE adjusted (%)	119.0	64.4	24.8	16.4	15.6
ROA adjusted (%)	39.5	29.8	11.4	7.2	6.7
Net debt to equity (%)	50.4	75.9	96.7	105.0	113.3
Interest coverage (x)	11.8	12.0	4.9	3.7	3.2

For further data queries on Citi's full coverage universe please contact CIR Data Services Asia Pacific at CIRDataServicesAsiaPacific@citi.com or +852-2501-2791

Powered by: dataCentral

Company Background

HDIL is part of the Wadhawan Group (founded in 1996), and among the leading slum rehab developers having rehabilitated close to 30,000 families to date – implying a potential 40% market share (excluding airport project). It has developed ~12m sq ft of SRA projects. Its expertise and past track record in execution of these projects has built up a competitive advantage for itself in this business that has high entry barriers. The company primarily operates in the Mumbai Metropolitan Region having presence across all assets, its focus being commercial and retail projects. Historically, HDIL has followed a build-sell model strategy (given thrust on SRA projects) and intends to follow the same for most of its projects. The company raised ~Rs17bn via an initial public offering (IPO) on July 2007 at Rs500/share for funding its land acquisition and ongoing slum rehab projects. Promoters control and manage the company with a 61.5% stake.

Investment Thesis

Sell with target price of Rs118

We initiate coverage of HDIL with a Sell/High Risk rating and a target price of Rs118 at a 40% discount to our Mar'09E NAV of Rs196 – offering 15% downside. Given HDIL's high risk-reward model and negative sentiments for property, particularly the Mumbai market where we see significant price/absorption risk over the next 12 months, we believe risks outweigh the positives. We attribute the 40% discount to the following: 1) regulatory/political risks as HDIL's NAV is sensitive to higher FSI (Floor Space Index) norms and softening TDR/asset prices; 2) likely execution delays in the airport project resulting in penalties; 3) tight liquidity crunch; and 4) concentration risk in Mumbai suburbs (89% of Gross NAV) where price risk/supply overhang is high.

HDIL's expertise and strong track record in slum rehab projects (57% of Gross NAV) does provide the company with a competitive advantage, a large development opportunity that is highly profitable, but we believe this is a high-risk business. The airport rehab project is a big win and will provide HDIL with visibility and contribute Rs85/share (46% of our Gross NAV) to our NAV. Though the pace of Phase I execution is encouraging, we see correcting TDR prices/rentals, absorption issues and execution delays amidst deteriorating macro adversely affecting stock sentiment. A weak outlook for the Mumbai market (89% of HDIL's Gross NAV) and volatile capital markets further add to these woes. Factoring this, the company's liquidity crunch, downside risks to earnings and the stock up 61% over the last one month, risk-reward is unfavorable.

Strategic Initiatives and Strengths

Leverage on expertise in slum rehab – large opportunity, high entry barriers...but risky

HDIL is a market leader in slum rehab projects having completed 12m sq ft of slum rehab

HDIL is among the leading slum rehab developers having rehabilitated close to 30,000 families to date, implying a potential 40% market share (excluding the airport project). HDIL has developed ~12m sq ft of SRS saleable area and rehabilitation area since 1996. Its expertise in handling the slum dwellers, familiarity with the regulatory process and strong track record in execution of these projects has allowed it to build up a competitive advantage for itself in this business that has high entry barriers. The company plans to leverage on this expertise to secure marquee projects such as the Mumbai Airport project. HDIL has consciously adopted the SRS (Slum Redevelopment Scheme) route to acquire high-value, low-cost land in Mumbai. Fifty-seven percent of its Gross NAV is derived from SRS projects (~37% of landbank including the airport project). Though we see this as a large development opportunity that is highly profitable and that HDIL is best positioned to take advantage of, it is a high risk business given the downturn.

Mumbai the domain – a high value, high risk market today

The Mumbai Metropolitan Region accounts for 89% of HDIL's Gross NAV and 87% of its landbank

Mumbai has huge potential for slum redevelopment given that ~2.8bn sq ft (over 1 million slums) of space is occupied by slum dwellers, of which only ~21m sq ft has been developed so far. Mumbai has traditionally been the commercial hub of India. High demand, prices and limited supply make it attractive versus other metro cities. The city has huge development potential. However, inadequate transport infrastructure, FSI constraints and dense slum population (over 1 million slums) are some of the key constraints that have historically impeded this development in Mumbai. We see higher near-term risks emerging of softening prices/rentals, supply overhang and execution delays for Mumbai's property market in this slowing environment and volatile capital markets, a key sentiment driver for Mumbai's property market. While the company has ventured into other markets such as Hyderabad, Kochi and Pune, with 87% of HDIL's landbank (196m sq ft) and 89% of Gross NAV coming out of Mumbai and its suburbs, its fortunes remain dependent on the outlook for the Mumbai market.

Figure 1. HDIL Landbank Summary (million sq ft)

Mumbai Metropolitan Region	**171.1**
-Airport TDR	53.2
-Airport Saleable Area (airport and rehab area)	14.0
-Non Airport Slum Rehab	4.6
-Residential	68.9
-Commercial & Retail	30.3
Hyderabad	**9.0**
Kochi	**15.0**
Pune	**1.2**
Total	**196.3**

Source: Company Reports, Citi Investment Research

Airport project a big win (46% of Gross NAV)

HDIL will get 65 acres; saleable area of ~8.5m sq ft around the airport after rehabilitating slums

Given HDIL's expertise in the slum redevelopment model, MIAL (Mumbai International Airport Ltd) run by the GVK group, awarded the slum rehabilitation project to HDIL in October 2007 – a big win for the company. The agreement envisages HDIL rehabilitating ~85,000 families living in slums encroaching on 276 acres of the airport land. As per the arrangement, MIAL will use part of the freed up area to modernize and expand the existing airport; and the balance will be split for development in favor of MIAL and HDIL in a 55:45 ratio – providing HDIL with 65 acres, which converts into 8.5m sq ft saleable area assuming an FSI of 2x. Additionally, the company will be compensated via TDR (Transfer of Development Rights, similar to land rights) worth ~53m sq ft (~10m sq ft land TDRs and ~43m sq ft of construction TDRs) from government authorities for rehabilitating the slums. This apart, the project is tax exempt under the 80-IA scheme (but would be liable to the minimum alternate tax rate of ~12% versus peak rate of 34%).

Phase I execution encouraging, but TDR/FSI absorption an issue and timely completion will be key

Phase I rehabilitation of ~22,000 families over ~59 acres in Kurla began in Jun'08; targeting completion by Dec'09

Both the scale and pace of construction for Phase I of HDIL's airport rehabilitation project in Kurla are encouraging. The company has started construction for Phase I (~5.5m sq ft) for rehabilitating ~22,000 families on ~59acres in Kurla (close to the airport site), targeting to complete in 15-18 months (Dec'09). This apart, management expects to start Phase II by 1QFY10 for rehab of another ~25,000 families and targets to rehabilitate ~50,000 families by Dec'10. It has already tied-up 150 acres (of 180 acres required) for the rehab project, most of which being substantially paid. Benefiting from the recent increase in FSI to 4x on slum rehab, the company is expected to get saleable area of ~5.5m sq ft, which is also under construction along with its Phase I of rehab. It has already sold ~1.5m sq ft of land TDR available for Phase I.

Figure 2. Airport Project Valuation Assumptions

Land TDR m sq ft	10
Rehab TDR m sq ft	43
Saleable Area m sq ft	14
Rental assumptions	Rs94/sq ft per mth
Saleable area FSI sales	Rs7,500/sq ft
TDR Price Range	Rs1,350-1,800/sq ft
Families	~85,000
Timeline	9 yrs
Project NAV	~Rs85/share

Source: Company Reports, CIR

While all this is encouraging; we see softening demand, sharp correction in TDR prices, absorption issues, and outstanding receivables of Rs1.5bn (as of Sept'08) on TDR sales done in 2Q as early signs of a worsening environment. Further, given social-political issues and changing regulatory norms surrounding slum rehab projects, risks of execution delays remain. However, being a critical project for the city and given the government's support, we should see timely completion of this project by FY12, otherwise HDIL will be liable to a penalty (~Rs2bn) in case of delay. We expect this project to contribute Rs85/share to our NAV estimate, factoring in saleable area of ~14m sq ft and TDR sales of ~53m sq ft (revenue recognition for TDRs to start from FY09) all to be executed by 2017 (versus management guidance of 2014). However, as a conservative measure we have not built in any additional saleable area available to the company from future phases of rehab, which could be potential upsides.

Figure 3. Recent HDIL TDR & FSI Sale Transactions

1.5m sq ft of airport TDR and 0.15m sq ft of FSI in Bandra (w) sold in 2QFY09
0.3m sq ft FSI sold in Santacruz project in 1QFY09
Andheri (Kaledonia) project sold to Mack Star Marketing in 4QFY08
Part of BKC project sold to Adani Group

Source: Company, Citi Investment Research

Operates rehab/build-sell model, but asset mix geared toward commercial assets

HDIL operates on a rehab/build-sell model for most of its projects, particularly FSI in SRA projects and residential developments. This is in-line with its strategy for monetizing landbank at the earliest and getting maximum tax benefits on its SRA projects. Its plans to adopt a sale/lease approach for built-up office/retail projects (non-airport comm/retail projects are 22% of the landbank) has, however, been put on hold given the current liquidity crunch and demand slowdown.

With the company's asset mix relatively geared toward TDR/Comm/Retail (75% of Gross NAV) assets, we see higher risks to HDIL's model: 1) increasing price/rental pressures on back of softening demand in Mumbai's office/retail market and 2) supply overhang in office space building for which we have factored in a 25% price decline and execution delays.

Risks outweigh the Positives

Regulatory risks – likely to spoil the party

We see higher regulatory risks for HDIL given its sensitivity to policy changes on FSI norms in Mumbai. Regulatory changes proposed by the government of Maharashtra (GoM) some time back could have an adverse impact on demand and prices for TDR, directly affecting HDIL's profitability (largest TDR generator).

- Proposed increased FSI for suburban Mumbai from 1.0x to 1.33x and offer to sell the incremental 0.33x of FSI at a 20-70% discount to the government ready reckoner rate.
- Increase in rehab area for slum rehab projects from 225 sq ft to ~269 sq ft (carpet area) per tenement; and higher FSI from 2.5x to 4x for high density slum rehab projects likely to result in higher TDR generation.
- Proposal to levy FSI cost (25% of ready reckoner rates) on future slum rehab projects is likely to reduce the profitability of future SRA projects (we see no immediate impact on HDIL's NAV, as all projects are pre-Apr'08).

Figure 4. Regulatory Changes in Mumbai

Increase in rehab area (carpet) per tenement to 269 sq ft from 225 sq ft.

Increase in FSI to 4 from 2.5 for high density slum rehab projects.

Proposal to levy FSI cost (25% of ready reckoner rates) on future slum rehab projects.

Cap on space for Financial Institutions in IT Parks in Mumbai Metropolitan Region increased to 80% from 30%.

Incentive FSI to encourage earmarking of space for public parking. Additional FSI granted will be 40%-50% of the parking area.

Source: News Reports, Citi Investment Research

TDRs (Transferable Development Rights) are typically bought by developers to increase effective FSI from 1.0x to 2.0x. After these changes, we could see higher FSI and increased TDR generation adversely affecting demand and prices for TDRs (15% of Gross NAV) – a market HDIL dominates. As a conservative measure, we have factored average TDR prices of ~Rs1390/sq ft (versus ~Rs2300/sf in 2Q09) in HDIL's NAV, but dampened demand and regulatory changes on increasing FSI norms could adversely affect TDR prices/absorption.

Concentration risks in Mumbai suburbs

Makes HDIL vulnerable to price, absorption and supply overhang amidst softening demand in the city

With 87% of HDIL's landbank (196m sqft) and 89% of Gross NAV coming out of Mumbai's mostly suburban areas, we see concentration risk for HDIL. This poses risks of absorption and softening prices/rentals in the current slowing demand environment. Further, we see building supply adversely affecting the company, particularly office space in Mumbai (See Annexure 1) – this market is likely to see supply of ~29m sq ft over the next 2-3 years. While timely execution of this supply remains a challenge amidst the liquidity crunch and dampened sentiments, this will remain an overhang. Recent policy change to increase usage of non-IT space from 30% to 80% in IT-Parks in Mumbai would further add to these supply concerns and dampen rentals.

Figure 5. Upcoming Office Projects of Select Developers in Mumbai Metropolitan Region

Developer	Location	Area (m sq ft)
Akruti City	Andheri, BKC, Kanjurmarg, Thane	2.45
DLF	Parel	1.90
HDIL/Mack Star Marketing	Andheri, Bhandup, Mulund, Turbhe	3.90
Indiabulls Real Estate	Parel	2.90
Kanakia	Andheri, Borivali, Rabale	1.77
Lodha Group	Kanjurmarg, Mahalaxmi	0.90
Man Infraprojects	Bandra, Nerul, Vile Parle	0.68
Marathon Realty	Mulund, Parel, Panvel	2.45
Neptune	Kurla, Mulund, Thane	2.54
Oberoi Constructions	Goregaon	0.70
Orbit Corp	Kalina, Parel, Sakinaka	0.83
Peninsula Land	Parel, Kurla	2.10
RNA	Bandra	0.15
Rustomjee	Andheri, Sion, Thane	4.98
Shree Naman Developers	BKC	0.26
Total		**28.50**

Source: Company Reports, ET Realty, Citi Investment Research

Potential funding constraints

High debt levels likely to lead to capital constraints raising cost of funding

We see risks emerging for HDIL, as debt levels rise to Rs39b in Sep'08 vs. Rs31b in Mar'08 and Rs17b in Dec'07, on payout for land costs and construction finance need for airport rehab. With debt/equity at ~0.9x, the company's average cost of debt at 15.5% levels and pre-sales drying up over the last 2-3months, outstanding on TDR sales – we see the liquidity crunch intensifying. Although the company has managed to roll over Rs3.5bn of the short-term debt of Rs5.5bn maturing in 2HFY09, with more construction finance needed for subsequent airport rehab phases we foresee liquidity constraints continuing for a while until the demand environment improves.

Financials

Adopts project completion method

HDIL is among the few developers that adopt a conservative method of project completion method of accounting, under which revenue on a project is recognized only when the project is fully completed, with the risks and rewards of ownership of a unit being completely passed on to the buyer. This method of accounting is quite conservative as compared with other players in the industry, who follow a percentage of completion method. However, the reported income can be lumpy in certain years, as it recognizes projects only once completed.

Downside risks to earnings

The key projects that are expected to be recognized over the next two years include Bandra SRS Scheme I, TDR sales in the Airport Phase I project and the Ghatkopar property. Rehabilitation work on the Bandra SRS scheme I is complete, whereas the airport project has started generating TDR from 2Q FY09. We forecast 5% revenue CAGR over FY08-11E. However, we estimate an EPS CAGR of -14% over FY08-11E due to: 1) lower margins on changing product mix and higher interest costs. That said, given the sharp deterioration in the demand outlook over the last 2-3 months, we see downside risks to earnings.

Figure 6. HDIL Income Statement (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Total Revenues	**12,042**	**23,804**	**24,744**	**22,084**	**27,620**
YoY Growth (%)	177%	98%	4%	-11%	25%
EBITDA	**6,620**	**16,921**	**14,026**	**11,969**	**13,920**
Margin (%)	55%	71%	57%	54%	50%
Depreciation & Amortization	(13)	(22)	(50)	(58)	(66)
Other income	206	529	582	640	704
EBIT	6,812	17,428	14,558	12,552	14,559
Interest income(expense)	(561)	(1,408)	(2,890)	(3,250)	(4,324)
Profit before tax	6,251	16,021	11,669	9,303	10,235
Tax	(771)	(1,922)	(1,459)	(1,163)	(1,279)
Profit after tax	**5,480**	**14,099**	**10,210**	**8,140**	**8,956**

Source: Company Reports, Citi Investment Research estimates

EBITDA Margins – likely to fluctuate

Given the conservative accounting method followed by HDIL, it is difficult to forecast margin trends. We expect margins to be in the range of 50-57% for FY09-11E; lower than FY08 margins, which were driven by one-off transaction of land sale in 4QFY08. While we expect EBITDA margins to come down as the product mix becomes more skewed toward lower-margin projects in distant suburbs, should the company choose to sell FSI in some of its slum rehab projects, margins could be higher. Rising costs, execution delays on slum rehab projects and softness in property/TDR prices if any could adversely affect margins.

Debt levels on the rise

HDIL debt levels are on the rise – concerning in current environment

HDIL's debt levels have increased to Rs39b in Sep'08 versus Rs31b in Mar'08 and Rs17b in Dec'07, on payout for land costs and construction finance for Phase I airport rehab. With debt/equity already at ~0.9x and pre-sales/TDR sales down significantly, we see the liquidity crunch intensifying. Although the company has managed to roll over Rs3.5bn of the short-term debt of Rs5.5bn maturing in 2HFY09, with more construction finance needed for subsequent airport rehab phases, we foresee liquidity constraints continuing.

Figure 7. HDIL Balance Sheet (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Source of Funds					
Equity Share Capital	1,800	2,143	2,755	2,755	2,755
Reserves	5,355	34,248	43,181	50,632	58,899
Net Worth	7,155	36,390	45,936	53,387	61,654
Deferred Liability	8	15	15	15	15
Minority Interest	0	1	1	1	1
Total Debt	3,757	31,127	48,160	59,083	73,283
Capital Employed	**10,920**	**67,534**	**94,112**	**112,486**	**134,953**
Application of Funds					
Gross Block	267	576	628	685	748
Depreciation	16	32	82	139	205
Net Fixed Assets	251	544	546	546	543
Capital WIP	3	52	58	63	69
Investments	1,578	1,915	2,106	2,317	2,548
Goodwill	23	91	91	91	91
Inventories	13,245	55,229	81,654	94,518	113,242
Sundry Debtors	3,113	566	742	994	1,243
Other Current Assets	1,239	13,108	15,184	20,921	25,477
Cash and Bank	57	3,505	3,751	3,034	3,425
Current Assets	17,653	72,408	101,332	119,467	143,386
Current Liabilities	(8,588)	(7,476)	(10,021)	(9,998)	(11,684)
Net Current Assets	9,065	64,933	91,311	109,469	131,702
Total Net Assets	**10,920**	**67,534**	**94,112**	**112,486**	**134,953**

Source: Company Reports, Citi Investment Research estimates

Valuation

We see HDIL positioned as a mid-scale developer with a high risk-high reward model - thus 40% discount to NAV is fair

Our target price of Rs118 is based on a 40% discount to an estimated core NAV of Rs196. We see HDIL positioned as a mid-scale developer with a high risk-reward model and expect it to trade at a 40% discount to NAV, which is toward the lower end of the average discount to NAV range of 35-50% for tier-II developers. While the level of NAV discount is a matter of subjective assessment, we believe that a 40% discount is fair, given HDIL's niche positioning in the slum rehab business, visibility from the airport project and its strong track record. This is in-line with our valuation methodology for Citi's India real estate universe. We attribute the discount to the following: 1) regulatory/political risks as HDIL's NAV is sensitive to higher FSI norms and softening TDR/asset prices; 2) likely execution delays in the airport project to result in penalties; 3) tight liquidity crunch; and 4) concentration risk in Mumbai suburbs (89% of Gross NAV) where price risk/supply overhang is high.

We believe an NAV-based valuation methodology is most appropriate for developers, as NAVs value landbank, along with development across asset classes factoring in spread out time frames. Our NAV estimate of Rs196 is based on the following assumptions: 1) 25% decline in current market prices, as Mumbai being high priced faces maximum downside risk; 2) development volume of 191m sq ft (based on Mar'09); 3) an average cost of capital of 18%; and 5) a lower tax rate of 26%, factoring in tax benefits for the slum rehab and airport project. We have also provided sensitivities to further TDR/price declines and airport project delay.

Figure 8. HDIL NAV Sensitivity

Price Change (excluding Airport TDR)			
	-10%	**-15%**	**-20%**
NAV/share (Rs)	153	132	110
TDR Price Change			
	-10%	**-15%**	**-20%**
NAV/share (Rs)	182	174	167
Delay in Airport project (TDR & Saleable area)			
	3 months	**6 months**	**12 months**
NAV/share (Rs)	190	184	172
Cost of Capital			
	15%	**16%**	**17%**
NAV/share (Rs)	236	222	209

Source: Citi Investment Research estimates

Figure 9. HDIL NAV Summary (Rs Millions)

Gross NAV of Residential Development	37,851
Gross NAV of Commercial Development	89,078
Gross Total NAV	**126,929**
Less: Amt outstanding for land	7,750
Less: Tax @ 26%	30,858
Less: Debt Outstanding	39,478
Less: Customer Advances	1,480
Add: Cash	4,016
Add: Cost of 2,300 acres acquired for Vasi-Virar SEZ	2,600
Net NAV	**53,979**
No. of Shares Outstanding (Millions)	275
NAV Per Share (Rs)	**196**

Source: Citi Investment Research estimates

The stock has significantly outperformed the Sensex by 41% and BSE Realty by 11% over the last one month. With the overall outlook for property weak, higher risks of a slowdown in Mumbai given changing regulatory norms, building supply and higher execution risks, we see downside risk for the stock from current levels.

Risks

We rate HDIL High Risk. This is different from the Speculative Risk rating assigned by our quantitative risk rating system (which measures the stock's volatility over a 260-day period). The key reasons for our High Risk rating include: 1) encouraging progress on Phase I of airport rehab project, 2) expertise and track record in slum rehab projects, a high risk-high reward business. The main upside risks to our investment thesis and target price are 1) change in regulatory policy, favoring TDR prices, 2) more benefits/incentives offered by the government to compensate for airport rehab costs, 3) significant FSI pre-sales easing its liquidity crunch and 4) meaningful recovery in demand, particularly office space in the Mumbai market.

Annexure 1

Figure 10. Upcoming Office Projects of Select Developers in Mumbai Metropolitan Region

Developer	Project	Location	Area (m sq ft)
Akruti City	Akruti Trade Point	Andheri	0.17
	Akruti Star	Andheri	0.35
	Akruti Sapphire	Andheri	0.30
	Akruti Iris	Andheri	0.65
	Akruti Topaz	BKC	0.06
	Akruti Corporate Park	Kanjurmarg	0.24
	Akruti SMC	Thane	0.17
	Akruti Greentech Park	Thane	0.50
DLF	NTC Mills	Parel	1.90
HDIL	Kaledonia (sold to Mack Star Marketing)	Andheri	0.55
	IT Park at Kilburn Premises	Bhandup	1.00
	IT Park and Office Space at Bombay Oxygen Premises	Mulund	0.75
	IT Park at Eveready Premises	Turbhe	1.60
Indiabulls Real Estate	Jupiter Mills	Parel	1.40
	Elphinstone Mills	Parel	1.50
Kanakia	215 Atrium	Andheri	0.30
	Western Edge - I	Borivali	0.42
	Western Edge - II & III	Borivali	0.74
	Sigma IT Park	Rabale	0.31
Lodha Group	iThink Techno Campus	Kanjurmarg	0.50
	Lodha Excelus	Mahalaxmi	0.40
Man Infraprojects	Man Mercury	Bandra	0.04
	IT Park	Nerul	0.55
	Man House	Vile Parle	0.09
Marathon Realty	Marathon Max Phase II	Mulund	0.05
	Nexzone	Panvel	2.10
	Futurex	Parel	0.30
Neptune Group	Evolution	Kurla	1.50
	Uptown	Mulund	0.04
	IT Park	Thane	1.00
Oberoi Constructions	Commerz	Goregaon	0.70
Orbit Corp	Orbit WTC	Kalina	0.33
	Hafeez Contractor House	Parel	0.23
	Business Park	Sakinaka	0.28
Peninsula Land	Peninsula Technopark	Kurla	0.90
	Peninsula Business Park	Parel	1.20
RNA	Bizz	Bandra	0.15
Rustomjee (Keystone Group)	Elita	Andheri	0.27
	Rustomjee Elita	Andheri	0.31
	Rustomjee Natraj	Andheri	0.28
	Rustomjee Aspiree	Sion	0.12
	IT Park	Thane	4.00
Shree Naman Developers	Naman Chambers	BKC	0.14
	Naman Centre	BKC	0.13
Total			**28.50**

Source: Company Reports, ET Realty, Citi Investment Research

Appendix A-1

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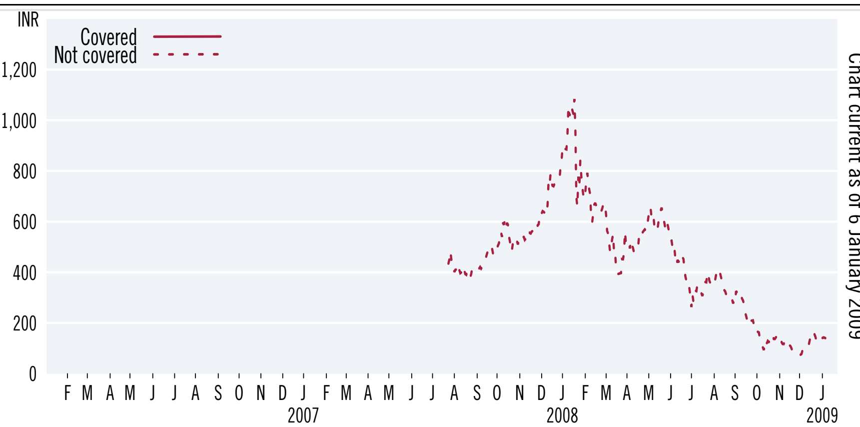

* Indicates change

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