

Company

23 August 2010 | 11 pages

Unitech (UNTE.BO)

Upgrade to Hold: Improving Outlook But Partly Priced In

 Equity
 Rating change
 Target price change
 Estimate change

- Lot of positives** — (a) Demand/execution pick-up – sold 16.6 msf in FY10 and construction picking up across the board; (b) Deleveraging has happened – debt equity now at ~0.5x – absolute debt at ~Rs60b against a peak of ~Rs109b; (c) Unitech Infra demerger could create value; (d) UCP restructuring should likely add value. Promoter stake has also gone up to ~47% post conversion of warrants.
- ... partly priced in, in our view** — The stock has already moved up ~20% in the last two months and trades at ~29% discount to our NAV, which will limit meaningful upside from present levels. Unitech Infra demerger could be a potential catalyst but again partly priced in post the announcement, in our view.
- NAV & TP go up to Rs113 & Rs96** — Our NAV goes up to Rs113 (from Rs88 earlier) as we factor in (a) Faster execution – as demonstrated in last few quarters; (b) Lower net debt levels; (c) Latest update on landbank. As of now, we value the Unitech Infra business at ~Rs20 per share (mainly Uninor stake and UCP portfolio). We now ascribe a lower discount to NAV of 15% (vs. 25% previously) as the business shows improvement and D/E is at more comfortable levels of ~0.48x.
- Progress on Mumbai business** — (a) On the Omkar JV – only part of existing projects now. Unitech is looking at various exit options. Under construction is <1msf. Termination of this JV reduces Unitech's exposure to Mumbai meaningfully. (b) Golibar project to launched by end of the year (total saleable area is ~18msf). Out of 26k families, 3.5k families have been moved.
- Upgrade to Hold** — While we are more positive now post deleveraging and a pick-up in execution, likely limited upside keeps us on the sidelines. Stock price correction of ~10-15% could create a buying opportunity, all else being equal. Key upside risks are (a) Better than expected execution (b) Unitech Infra being valued up closer to demerger. Execution delays remain the biggest challenge – projects started before March 09 could possibly get delayed beyond the earlier timeline.

Hold/Medium Risk	2M
<i>from Sell/Medium Risk</i>	
Price (23 Aug 10)	Rs85.05
Target price	Rs96.00
<i>from Rs66.00</i>	
Expected share price return	12.9%
Expected dividend yield	0.0%
Expected total return	12.9%
Market Cap	Rs214,144M
	US\$4,594M

Price Performance (RIC: UNTE.BO, BB: UT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	16,613	10.23	27.2	8.3	3.8	59.4	0.3
2009A	11,977	7.38	-27.9	11.5	2.7	27.3	0.0
2010E	6,751	2.77	-62.5	30.7	2.0	8.6	0.0
2011E	8,461	3.47	25.3	24.5	1.7	7.4	0.0
2012E	13,180	5.40	55.8	15.7	1.5	10.2	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	8.3	11.5	30.7	24.5	15.7
P/E reported (x)	8.3	11.5	30.7	24.5	15.7
P/BV (x)	3.8	2.7	2.0	1.7	1.5
Dividend yield (%)	0.3	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	10.23	7.38	2.77	3.47	5.40
EPS reported	10.23	7.38	2.77	3.47	5.40
BVPS	22.18	31.84	43.09	50.17	55.57
NAVps ordinary	na	na	na	na	na
DPS	0.25	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net operating income (NOI)	24,200	15,935	10,967	13,647	20,378
G&A expenses	-2,161	0	0	0	0
Other Operating items	-150	-222	-346	-378	-431
EBIT including associates	21,889	15,714	10,621	13,269	19,947
Non-oper./net int./except.	-1,155	-1,334	-1,415	-1,679	-1,892
Pre-tax profit	20,733	14,380	9,205	11,590	18,055
Tax	-3,986	-2,424	-2,264	-3,129	-4,875
Extraord./Min. Int./Pref. Div.	-134	21	-191	0	0
Reported net income	16,613	11,977	6,751	8,461	13,180
Adjusted earnings	16,613	11,977	6,751	8,461	13,180
Adjusted EBIT	21,833	15,726	10,626	13,269	19,947
Adjusted EBITDA	22,038	15,935	10,967	13,647	20,378
Growth Rates (%)					
NOI	23.4	-34.2	-31.2	24.4	49.3
EBIT adjusted	19.8	-28.0	-32.4	24.9	50.3
EPS adjusted	27.2	-27.9	-62.5	25.3	55.8
Cash Flow (RsM)					
Operating cash flow	-7,510	76	6,524	-1,968	4,475
Depreciation/amortization	205	209	341	378	431
Net working capital	-26,985	-10,784	-9,439	-9,885	-8,215
Investing cash flow	-26,917	-15,525	-13,034	-8,524	-10,802
Capital expenditure	-23,508	-1,988	-13,015	-8,524	-10,802
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	45,544	2,935	16,764	6,126	2,500
Borrowings	45,935	1,263	-29,878	-2,680	2,500
Dividends paid	-475	-475	0	0	0
Change in cash	11,116	-12,513	10,254	-4,366	-3,828
Balance Sheet (RsM)					
Total assets	224,976	262,927	309,333	349,205	392,087
Cash & cash equivalent	14,083	6,448	7,870	4,425	1,519
Net fixed assets	31,442	33,257	45,931	54,078	64,449
Total liabilities	187,812	210,618	203,630	226,236	255,938
Total Debt	85,524	90,558	60,680	58,000	60,500
Shareholders' funds	37,163	52,309	105,702	122,969	136,149
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	53.1	54.3	35.9	31.1	37.2
ROE adjusted (%)	59.4	27.3	8.6	7.4	10.2
ROA adjusted (%)	9.3	4.9	2.4	2.6	3.6
Net debt to equity (%)	192.2	160.8	50.0	43.6	43.3
Interest coverage (x)	7.9	2.9	5.5	6.5	9.4

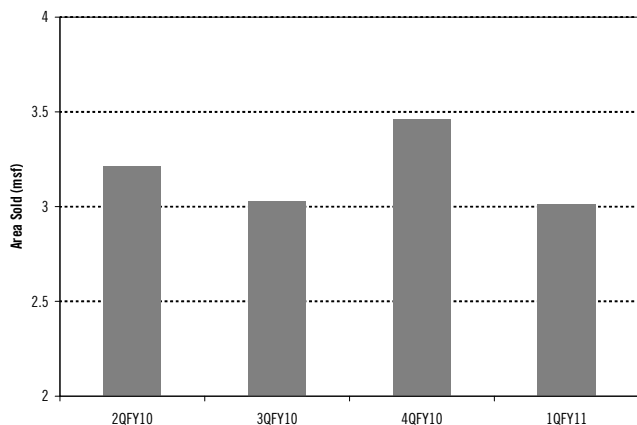
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Sharp pick-up in demand as well as execution

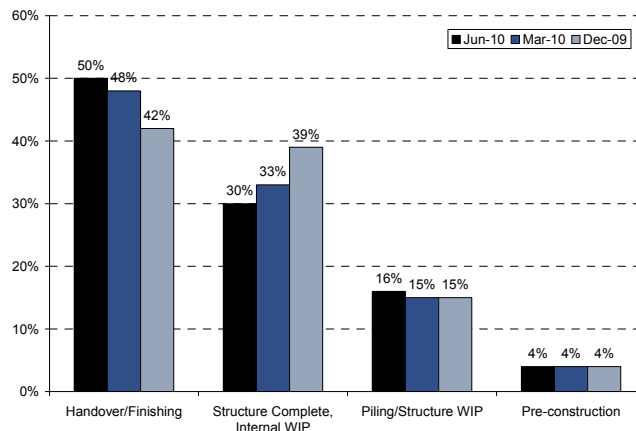
Unitech has operationally delivered well over the last few quarters. Execution and pre-sales have meaningfully picked up. With demand remaining healthy (except in pockets, where pricing has moved up sharply), we expect good execution and sales to continue going forward.

Figure 1. Quarterly Sales Tracker (in msf)



Source: Company Reports

Figure 2. Construction Progress In Past Projects

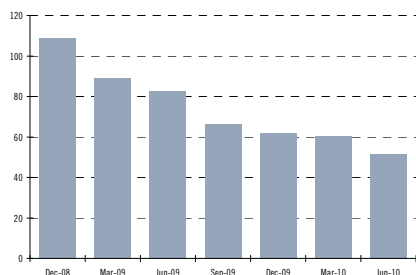


Source: Company Reports

Debt-equity at comfortable levels

Unitech has been able to deleverage successfully with a couple of rounds of equity issuances and given strong execution and cash generation. The promoters are also likely to fully convert the warrants, which also infuses cash into the company. Debt-equity has come off to 0.48x – with which the company is very comfortable. Incrementally, the company has also been able to correct the asset-liability mismatch, replacing some short-term funding with longer-term funding. From a peak debt of ~Rs109b, net debt levels have come down to ~Rs52b. We expect D/E to reduce further (unless the company goes in for meaningful land acquisitions or the market slows down).

Figure 3. Debt:Equity Over Past Few Quarters



Source: Citi Investment Research and Analysis

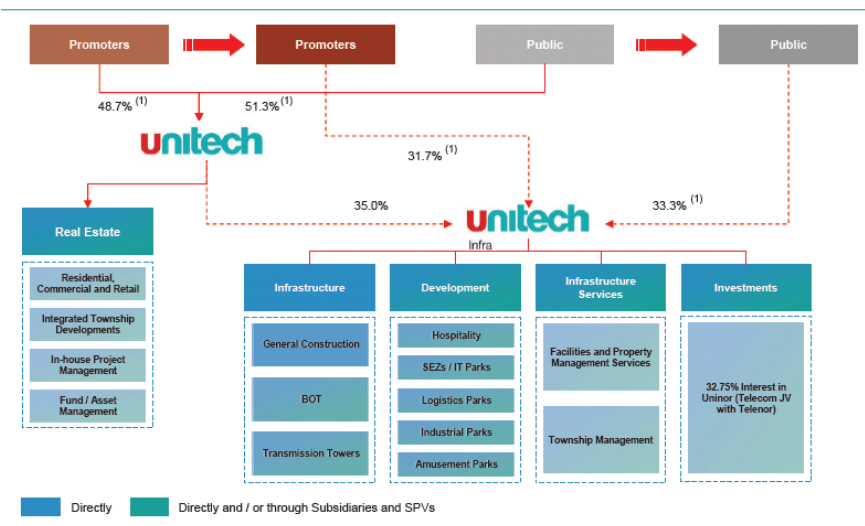
Unitech demerger – could create value

Unitech’s board had approved the demerger of its non-core businesses – Transmission towers (100%), Amusement park (50%), UCP (40%), Uninor Wireless (32.5%) – to a separate entity called Unitech Infra, at a swap ratio of 1:1, which would be listed separately by year end. Unitech would hold 35% in the same, promoters would hold 32% and balance would be held by the public. Intention is primarily to unlock further value, make these businesses self funded and renew focus on core real estate business.

Operationally, Unitech would focus purely on a develop-sell model (largely residential). It would transfer ~400 acre land, Rs3.5bn debt and some of its ongoing consulting revenue to the infra vehicle, which going forward would look to monetize assets/investments in hotels/amusement parks/SEZs/telecom venture and grow their presence in the infrastructure space.

Restructuring could unlock value and allow easier access to funding for Unitech Infra

Figure 4. New Corporate Structure Post-Restructuring



Source: Company Presentation (1-Shareholding pattern assuming that the bal. 177.5m warrants convertible into equity shares that are held by the Promoters are exercised)

We currently value the Unitech Infra assets at ~Rs20 per share. The objective of the restructuring is to unlock value and allow easier access to funding for the infra company.

UCP restructuring – likely accretive

UCP restructuring – likely accretive even with conservative assumptions

Unitech recently announced that it plans to buy its AIM-listed (London) group firm Unitech Corporate Parks (UCP) in a deal that would cost around Rs7.5b (which is meaningfully lower than the £360m which UCB had raised in Dec 2006). While still under contemplation, the deal is proposed to be at 31 pence per share. Unitech owns 4.5% in UCP while promoters own 0.22%.

Figure 5. UCP's Seed Portfolio

UCP Asset	Details	Area (in acres)
Infospace (G1-ITC)	IT/ITES SEZ in Gurgaon	25
Infospace (G2-IST)	IT/ITES SEZ in Dundaheera, Gurgaon	28
Infospace (N1)- Sec 62	IT Park Noida	19
Infospace (N1)- Sec 135	IT/ITES SEZ in Noida	30
Infospace (N3)	IT/ITES SEZ in Greater Noida	50
Infospace (K1)	IT/ITES SEZ in Kolkata	45

Source: Company

The 6 corporate parks, which are part of UCP, have total leasable area of ~21msf, although the area leased currently is only ~1.05 msf (data as of Sept, 2009). Even assuming 3mf of leased area at Rs45 rental pm and 10% cap rate over the next 3 years, the transaction would be value accretive at 30% premium to the present offer price of 31 pence per share. However, the value accretion may be limited given that investors will not be ready to value potential projects highly at this stage.

NAV upgraded to factor in pick-up in execution pace, lower debt and updated landbank

Revenue estimates increased to factor in better sales/execution; EBITDA for FY11 is largely unchanged due to lower margins

Increase NAV to Rs113/share

We increase our NAV and target price to Rs113 (vs Rs88 earlier) and Rs96 (vs Rs66 earlier). The key changes are highlighted in the table below:

Figure 6. Unitech NAV Summary

In Rs mn	New	Old
Gross NAV Residential	414,575	232,019
Gross NAV Non-Residential	142,645	138,539
Total Gross NAV	557,219	370,558
Less: Amt outstanding for land	17,940	17,900
Less: Tax @ 27%	145,605	95,218
Less: Debt outstanding	60,130	78,700
Less: Customer Advances	86,410	68,000
Add: Stake in Telecom Business	29,901	29,804
Add: Cash	8,560	10,000
Add: Cash from asset sales & QIP	0	26,211
Net NAV	285,595	176,755
NAV / share (Rs)	113	88

Source: Citi Investment Research and Analysis

The key reasons for the changes to our NAV are:

- Pick-up in execution pace – as demonstrated in last few quarters
- Lower net debt levels
- Factoring in the latest update on landbank. We now value ~450msf of saleable area.

Changes to estimates

While our assumptions/estimates are conservative to the guidance provided by the management, our revenue numbers are increased on the back of improved pre-sales and execution. This is partly offset by increases in operating costs, funding costs, depreciation and lower other income. Hence, in spite of significant topline growth, our EBITDA and net profit remain largely stable in FY11 (mainly due to spillover of past projects) and increase in FY12 as operating margins improve.

Figure 7. Changes in Unitech's Estimates

FYE	Sales	EBITDA	Net Profit	EPS	%
31 Mar	(RsM)	(RsM)	(RsM)	(Rs)	chg
2011E	42,646	13,647	8,461	3.47	-3.46
Prev	31,157	13,934	8,584	3.59	
2012E	53,626	20,378	13,180	5.40	13.36
Prev	42,062	17,792	11,388	4.77	

Source: Citi Investment Research and Analysis

Most positives are priced in after the 20% upward move in the last two months; a 10-15% correction could provide a buying opportunity

Why not Buy?

While we are incrementally more positive for reasons highlighted above, we believe that the stock is attractive only at 10-15% lower levels (all else being equal):

- Unitech trades at ~29% discount to NAV, which does not leave too much room for disappointment.
- Lot of the positives – deleveraging, pick-up in business, Unitech Infra announcement – are largely factored in the ~20% uptick already seen in the stock over the past two months.
- Profitability will be subdued in the coming quarters given the mix change (towards value housing – longer term potential) and delays in projects started before March 2009, which are consuming increased costs.
- The Noida/Greater Noida market is a reasonable part (~8-9%) of the gross NAV and the market there has yet to pick up meaningfully – given the existing oversupply in the market. Also, Mumbai plans have been reduced meaningfully post termination of the Omkar JV.

Other things remaining the same, we would get constructive on Unitech at 10-15% lower levels.

Unitech

Company description

Unitech is one of India's largest, most diversified real estate developers with an emerging pan-India presence. It enjoys leadership in the markets of NCR and Kolkata. Its core strengths of land acquisition, reputation in building townships and relationships with governments and customers have enabled it to build a diversified portfolio. Unitech has a landbank of ~8000 acres with total saleable area of ~450m sq ft spread over Chennai (21%), NCR (22%), Kolkata (5%). Residential projects account for about 79% of the landbank, commercial (including IT Parks) 18% and the balance is in retail and hotels. Unitech Group has diversified into telecoms through a 33% stake in Uninor and also has a small presence in power transmission, prefabricated construction, paving block and ready mix concrete. The promoter family holds a ~46% stake in the company.

Investment strategy

We rate Unitech Hold/Medium Risk (2M) with a target price of Rs96. The recent equity raisings (incl. warrants) and non-core asset sales have eased a near-term liquidity crunch and leverage concerns. Debt:equity is now comfortable at 0.5x. Further, an encouraging response to the company's new launches and a pick-up in execution of its projects (both past and new) make us believe the worst is over. Given the stock has had a good run-up in last two months (up ~20%), however, we believe most of these positives are already priced in. Going forward, a further pick-up in leasing and execution, and likely corporate actions in the form of UCP acquisition and the listing of its de-merged Infra entity could act as potential catalysts. Hence, upgrade to Hold/Medium Risk at current levels.

Valuation

Our target price of Rs96 is based on a 15% discount to our Sept'11 NAV of Rs113. Our lower discount vs. tier-II peers (15-30%) is a combination of: a) a healthier balance sheet, b) improved pace of construction and execution, c) a large untapped landbank. Our NAV estimate of Rs113 assumes: a) development volume of 450msf; b) an average cost of capital of 13% (similar to peers); c) cap-rates of 10-11%; d) a value of ~Rs12 per share for Unitech's 32.75% stake in the telecom venture; and e) a tax rate of 27%.

Risks

We rate Unitech Medium Risk, in line with the risk rating flagged by our quantitative risk rating system, which tracks 260-day historical share price volatility. Upside risks to our target price include: 1) Better-than-anticipated response to the company's new project launches in the mid-income segment; 2) Hotel, office and school/hospital plots are sold at substantially higher-than-expected prices; 3) Potential corporate actions (UCP acquisition & Infra listing) leading to value accretion and 4) Release of pledged shares. Downside risks would include: 1) Delays in execution and 2) Poor response to project launches.

Appendix A-1

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Unitech (UNTE.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA
Covered since June 1 2010



Chart current as of 21 August 2010

	Date	Rating	Target Price	Closing Price
1	30-Oct-07	3M	*314.00	374.40
2	10-Feb-08	*1M	*454.00	351.05
3	11-Apr-08	1M	*375.00	262.80

	Date	Rating	Target Price	Closing Price
4	15-Jul-08	*2H	*193.00	153.55
5	2-Nov-08	2H	*57.00	48.05
6	1-Feb-09	2H	*37.00	32.15

	Date	Rating	Target Price	Closing Price
7	2-Apr-09	*3H	*34.00	37.50
8	1-Jun-09	*3M	*66.00	92.20

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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