Company Flash

31 January 2008 | 6 pages

DLF (DLF.BO)

3Q Results: Is Residential Business Recovering?

- **Revenues and profits rise** — 3Q FY08 consolidated revenues and net profit grew 11% and 6% qoq, respectively – strong growth for the third quarter running. The EBIDTA margin was 69.5%. The quarter saw a notable pick-up in launches and lease activity. Office continues to be a dominant segment, while Residential appears to be improving.
- **Sales to DAL increase** — DAL continues to be the primary driver of revenues/ acquirer of assets. Its share of revenues increased to 56% in 3Q FY08 (42% 2Q08) and accounts for 58% of PBT. Effectively, the focus and reliance on DAL is increasing, so does the importance of its office trust listing.
- **What's new** — a) Landbank: Additions to landbank in Hyderabad, Chennai, Pune and Gurgaon, taking total landbank to 748m sq ft; b) Area under construction: 59m sq ft, up 9% qoq – Commercial now accounts for 68%; c) Office leases/sales: 3.28m sq ft in 3Q, up from 2.45m sq ft in 2Q FY08; d) 2 high-profile South Delhi Malls (Emporio & Promenade), given for fit-outs; and e) Hotel sites: increased to 51 from 39.
- **Residential segment: Encouraging** — a) Project launches in Kolkata, Indore and Chennai; b) Apparently strong response – Kolkata project sold out in 4 days, in Chennai (OMR) 2,205 apartments sold in 1 week; c) Monetizing 7 residential assets – sale of 49% stake to private-equity investors, for Rs16.75bn.
- **Maintain Buy/Medium Risk** — DLF's valuations look attractive. The stock trades at a 3% premium to Sep 2008E NAV.

Buy/Medium Risk	**1M**
Price (30 Jan 08)	Rs862.20
Target price	Rs1,046.00
Expected share price return	21.3%
Expected dividend yield	0.7%
Expected total return	**22.0%**
Market Cap	Rs1,469,907M US$37,402M

Price Performance (RIC: DLF.BO, BB: DLFU IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,917	12.34	100.2	69.9	14.1	22.6	0.0
2007A	19,413	12.80	3.7	67.4	43.3	97.9	0.0
2008E	69,431	40.73	218.1	21.2	8.1	65.7	0.7
2009E	99,170	58.17	42.8	14.8	5.5	44.3	0.9
2010E	129,661	76.05	30.7	11.3	3.9	40.1	1.2

Source: Powered by dataCentral

Ashish Jagnani[1]
+91-22-6631-9861
ashish.jagnani@citi.com

Aditya Narain, CFA[1]
+91-22-6631-9879
aditya.narain@citi.com

Karishma Solanki[1]
karishma.solanki@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Figure 1. DLF 3Q and 9-month Earnings Summary

Rs in Millions	2QFY08	3QFY08	QoQ	9mFY08
Sales	32,499	35,984	11%	99,221
EBITDA	22,637	25,014	11%	69,689
EBITDA Mgn (%)	69.7%	69.5%		70.2%
Interest	36	788	nm	1,901
Depreciation	110	148	35%	424
Other Income	993	528	-47%	1,994
PBT	23,484	24,606	5%	69,358
PAT	20,182	21,389	6%	56,802
PAT after Minority & Associates	20,186	21,450	6%	56,790

Source: Company Reports and Citi Investment Research

DLF

Company description

DLF is one of India's oldest real estate developers. Established in Delhi in 1946, it has continued to expand and diversify its real estate businesses, and is among the largest developers in India. It has historically built its businesses in Delhi and adjoining areas, know as the National Capital Region (NCR). DLF has diversified into other geographic locations over the last few years. These expansions are spread across India, with a particular focus on the Northern India belt, Kolkata, Mumbai, Chennai, and a number of other large and rapidly growing cities. DLF enjoys a strong brand franchise with good reputation in execution and delivery. This is the flagship company of the KP Singh family with the founders holding ~90% (post the recent primary offering in Jul'07 at Rs525). It is amongst India's largest developers with diversified asset portfolio and an emerging pan-India presence.

Investment strategy

We rate DLF shares Buy/Medium Risk (1M), with a target price of Rs1,046 based on a 25% premium to our NAV estimate of Rs837 which includes other asset holding/JV businesses of Rs75. DLF's focus on scale, integrated development with execution record, and a large land holding spread across top-tier growth cities differentiates it from its peers. Its diversified portfolio of ~738m sq ft is relatively leveraged toward commercial/IT Parks/Retail mall (33% of total development) assets, which should provide a good hedge particularly in the near-term, when the residential segment is seeing some slowdown. We believe it is a good proxy to play potential yield compression. We see this as a core holding for playing the Indian real estate sector.

Valuation

Our target price of Rs1,046 is based on a 25% premium to our core NAV and other asset holding/JV estimate of Rs837. This includes Rs762 for the development portfolio and Rs75 for other asset holdings and new JV businesses (Rs45/share for the existing 4.6m sq ft of leased assets and 7.2m sq ft of plots, and Rs30/share for DLF's share in construction and hotel JVs). The premium is attributed to: 1) a diversified tier-I developer with large landbank; 2) high leverage towards office/IT Parks and retail assets; 3) a relatively de-leveraged balance sheet; and 4) a strong track record that provides it with potential to win large township projects. We believe an NAV-based valuation methodology is most appropriate for developers, as it factors the varied development projects and spread out time frame. Our NAV estimate of Rs837 is based on the following assumptions: 1) current market prices will persist, without any price inflation; 2) development volume of 701m sq ft (as ~43m is already/to be recognized as revenue till Sep '08); 3) a cap rate of 9% for commercial/IT Park, IT SEZs in Super Metros and Metros, and 10% for other locations; 4) all projects undertaken by DLF will be completed largely on schedule; though given the scale, we expect risk of delays; 5) average cost of capital of 14%; and 6) a tax rate of 25%.

Risks

We rate DLF shares Medium Risk. This is different from the Speculative Risk rating assigned by our quantitative risk-rating system to stocks that have less than one-year trading history. The key reasons for assigning a Medium Risk rating include: 1) the company's robust business model; 2) pan-India land bank with initiatives to de-risk the business model through new business JVs; and 3) relatively healthy cash flows, at a time when most developers are facing funding constraints.

The main risks to our investment thesis and target price include:

- The company's asset sale strategy remains contingent on capital flows, especially with the government exploring measures to regulate FDI in the sector.

- Poor response for its mid-income housing projects expected to launch in 3Q/4Q; a good response is crucial for growth ahead and cash flows, but the demand environment in the residential market remains sluggish.

- Slowdown in the IT/ITES industry which could lead to a decline in demand for commercial real estate. While there is strong demand for IT space, in event of the sector facing a slowdown, DLF could get adversely impacted due to its high leverage and scale.

- Slowdown in capital inflows or measures to regulate FDI in the real estate sector.

Appendix A-1

Analyst Certification

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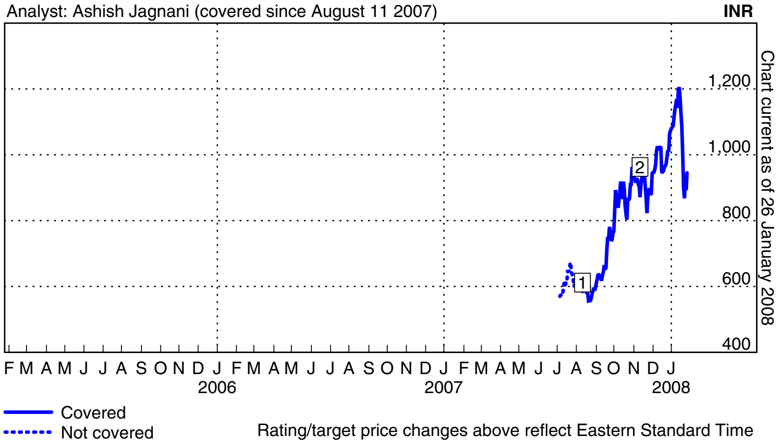
DLF (DLF.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since August 11 2007)



#	Date	Rating	Target Price	Closing Price
1:	10 Aug 07	1M	725.00	584.45
2:	12 Nov 07	1M	*1,046.00	871.20

*Indicates change.

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