Ambit Capital Pvt Ltd.

Company Update

DLF

Sell

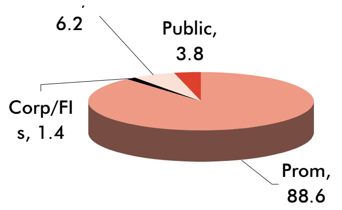
Price	Rs354
Target Price Rs157	**%Downside** 56↓
Market Capitalisation Rs598,176mn	(US$12,529mn)
52 week range H/L (Rs)	580/124
Shares o/s (mn) 1697.2	**Daily vol (mn)** 45.28
Reuters DLF.BO	**Bloomberg** DLFU IN

Perfm(%)	1M	3M	12M	YTD
Absolute	37.1	118.5	(28.1)	25.4
Relative	11.3	30.3	(26.2)	(19.3)

BSE Sensex	Nifty
14,876	4,484

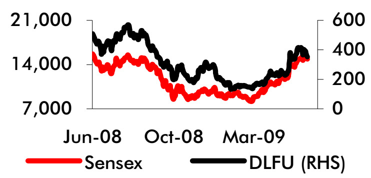
Source: Bloomberg

Shareholding pattern (%)



Source: Bloomberg

Price performance



Source: Bloomberg

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Optimism Overplayed; maintain 'Sell'

The recent rally in DLF's stock price suggests that markets are factoring in a 'V' shaped recovery. However, we expect the recovery to be 'U' shaped, given the weak margins in affordable housing and the continued slowdown in commercial and retail demand; this will maintain pressure on NAV. We maintain 'Sell' on DLF with a revised TP of Rs157 (earlier Rs80), a 56% downside from current levels.

Mkts pricing in 45% rise in property price-unsustainable

As per our sensitivity analysis, DLF's CMP (Rs354) is factoring in a 45% rise in property prices in FY10E, which, in our view, is unsustainable. Our recent visits to Delhi and Bangalore suggest that the buyer continues to be price conscious due to fear of job losses. Also, anecdotal evidence suggests oversupply in the affordable housing space arising from the entry of many developers in this segment; this will also limit any price rise.

Higher sales not to be margin accretive

Focus on affordable housing is likely to generate higher sales for DLF, but compress its EBITDA margins, from 55% in FY09 to 36 in FY10E. Moreover, with a price conscious buyer at one end and an oversupply situation on the other, DLF would find it extremely difficult to increase prices. Consequently, the company's margins are likely to remain subdued over the medium term.

Sensitivity analysis to property price

Our sensitivity analysis indicates that if property prices were to be increased by 50%, the NAV is 378. If the prices were to be increased by 100%, the NAV would rise to Rs600. If we assume a price rise in FY12 and FY13 of 30% each, then the NAV would stand at Rs258.

Two-pronged strategy - maintain sales & lower debt

To ensure sales, DLF is pricing its residential projects lower than the existing prices in the vicinity. This strategy has already ensured success for DLF in Delhi and Bangalore. DLF is also selling its non-core assets and land to lower debt.

Valuation

We maintain **'Sell'** on DLF with new TP of Rs157 (earlier Rs80) that is based on 1x NAV. Our NAV factors in the expected sale of non-core assets/ land and reduction in debtors. We have also lowered the discount to NAV to nil due to the aggressive steps taken by DLF to improve its balance sheet. Currently, the stock trades at 42x FY10E earnings and 41x FY11E earnings.

Key financials

YE March (Rs mn)	FY08	FY09	FY10E	FY11E
Revenues	144,530	100,440	56,769	61,965
EBITDA	97,306	54,880	20,288	20,519
EBITDA (%)	67.3	54.6	35.7	33.1
Net Profit	78,120	46,296	13,973	14,242
EPS (Rs)	45.9	27.5	8.4	8.6
RoE (%)	71.9	21.5	5.7	5.5
RoCE (%)	31.5	11.5	3.2	3.1
P/E (x)	7.7	12.9	42.1	41.3
P/BV (x)	3.1	2.4	2.3	2.2

Source: Company, Ambit Capital Research

Valuation

We have revised our NAV for DLF from Rs100/share to Rs157/share based on the expected cash inflows from the suggested sale of non-core assets and parcels of land. Our NAV is dependent on DLF's ability to sell its assets at the price suggested by the management.

The methodology for computation of NAV is given below.

- We have divided the entire land bank of the company into projects based on the information given by the company
- We have arrived at the sale price /sq. ft. and the anticipated sales volume for each project based on our interaction with industry experts
- We have deducted the cost of construction based on the assumed cost estimates. Our cost estimates have been arrived at after discussion with industry experts
- We have further deducted marketing and other costs that have been assumed at 4% of the sales revenue
- We have then deducted income tax based on the tax applicable for the project
- The resultant cash inflow has been discounted based on the WACC of 13%. All the project level NAV has been added to arrive at the company's NAV
- From the company's NAV, we have deducted the net debt as of FY10E to arrive at the final valuation of the company
- We have increased our NAV based on the sale/expected sale of non-core assets and land parcels by the company. Other adjustments include writing down of outstanding land payments since DLF has exited some projects

Exhibit 1:Details of change of NAV

	Old	Rs/share	New	Rs/share
Land bank (mn sq ft)	425		425	
NAV (Land Bank)	409,135	241	409,135	241
Net debt (FY10E)	239,980		239,980	141
Add: Cash from sale of Wind Power business			9,500	6
Cash from Bidadi+Dankuni			3,360	2
Cash received for exiting Dwarka Convention Centre			8,500	5
Cash received from DAL			38,640	23
Cash received from the Haryana Govt			8,000	5
Cash for the sale of Mumbai land			3,100	2
Other adjustments			25,716*	15
Adjusted net debt	**239,980**	**141**	**143,164**	**84**
Gross NAV	**169,155**	**100**	**265,971**	**157**
Shares outstanding (mn)	1,697		1,697	
NAV(Rs/share)	99		157	
Premium	-20%		0%	
NAV(Rs/share)	80		157	

*Note: *Includes write back of expected payment for land provided for in balance sheet*
Source: Ambit Capital Research

We have reduced our discount to NAV from 20% to nil. This reduction stems from the likely improvement in cash flows and balance sheet health as DLF takes aggressive steps to reduce its debt levels through:

1. Expected reduction in debtors from DAL through the sale of stake by promoters and the expected cash inflow into DLF by way of reduction in debtors
2. Expected stake sale in non-core assets like Wind Power Energy business
3. Sale of land

Key assumptions

1. Sales volume

We expect DLF's sales to remain muted in FY11E due to slowdown in demand in office and retail verticals; this slowdown can be attributed to a weak economy and a subdued IT/ITES sector arising from weakness in western countries.

Exhibit 2: Sales (mn sq ft)

	Current	Current	Current
Residential	9.2	7.7	9.0
Office	7.2	4.4	3.9
Retail	3.0	2.1	1.9
Total	**19.4**	**14.1**	**14.8**

Source: Ambit Capital Research

2. Sale price

Our channel checks reveal that with an improvement in sentiment and decline in prices to FY04 levels, there has been a large increase in inquiries and sales (relative to Dec08-Jan09) in the residential sector. However, we expect the price rise to be limited due to:

1. Anecdotal evidence of oversupply, as most of the cash strapped developers shift focus to affordable segment to maintain cash flows.
2. Drop in prices has increased interest and affordability amongst government employees, a segment typically not impacted by job insecurity.

Exhibit 3: Estimated price assumptions

	Residential (Rs/sq ft)	Office (Rs/sq ft/month)
Gurgaon	2600	75
Kolkata	2000	30
Chennai	2100	45
Bangalore	2000	NA
Pune	1900	NA

Source: Ambit Capital Research

3. Discount rate

Our discount rate is based on WACC. Our assumptions for WACC are given below.

Exhibit 4: Discount rate assumptions

Pre tax cost of debt	15.0%
Tax rate	24%
Cost of debt	11%
Cost of equity	
Risk free rate	7.0%
Beta	1.2
Market premium	6.0%
Cost of equity	14%
WACC	12.8%
Debt	1
Equity	1

Source: Ambit Capital Research

4. We have assumed that the sale price, the rental rates, and the costs will increase by 6% per annum.

Sensitivity Analysis - Markets pricing in a 45% rise in property prices

We have analysed the sensitivity of NAV to change in the selling price for the following scenarios:

1. We have assumed that prices will rise by 30% in FY12E and by 20% in FY13E.
2. We have assumed that prices will rise by 50% in FY10E
3. We have assumed that prices will rise by 100% in FY10E

The current stock price for DLF factors in a price rise of approximately 45% which is probably 3-4 years away. In the last cycle, prices bottomed in CY2002 and remained stable until CY2004 and peaked around CY2007. If we assume a 30% price rise in FY12, and a further price rise in FY13, we have a NAV of Rs258.

Exhibit 5: NAV sensitivity to change in price

		50% rise FY10	100% rise FY10	30% rise FY12 & FY13 each
	Base case	Case 1	Case 2	Case 3
NAV (Rs/share)	157	378	600	258

Source: Ambit Capital Research

Two pronged strategy

Slowdown in the IT/ITES sector has plummeted rental rates and increased vacancy levels. Therefore, DLF has shifted its focus to

1. Affordable housing
2. Reduction in debt to improve balance sheet

Affordable Housing - sale at property prices below the market price

DLF's strategy to launch at a discount to local prices has enabled it to maintain good sales in a weak environment. This was seen in the recent launch in Delhi (launch price of Rs4,500-5,500 vs. existing price of Rs7000-8,000/sq ft). In Bangalore too, after a weak response to its launch at Rs2,800/sq. ft., DLF has generated good response by re-launching the project at Rs1,800/ sq. ft.

DLF plans to launch and sell 7-8mn sq. ft. of residential space in FY10 in city centres in Delhi, Gurgaon, Chennai, and Kochi. We believe that attractive pricing in well-located projects will enable DLF to maintain sales. Also, in FY10, it plans a further launch of 5-6mn sq. ft. of projects at the city outskirts of Bangalore, Hyderabad, New Gurgaon, and Chennai.

Reduction in Debt

The second part of the strategy focuses on reduction in debt levels to improve balance sheet health. To reduce debt, DLF has sold/exited from some of its land parcels and non-core assets like Wind Power Energy business. Based on DLF's disclosure, we expect the cash inflow to stand at Rs71.1bn (see exhibit 6). The maximum cash inflow is likely to be from DAL by way of reduction in debtors.

Exhibit 6: Expected cash inflows through sale of non-core assets / land

	Rs mn
Add: Cash from sale of Wind Power business	9,500
Cash from Bidadi+Dankuni	3,360
Cash received for exiting Dwarka Convention Centre	8,500
Cash received from DAL	38,640
Cash received from the Haryana Govt	8,000
Cash for the sale of Mumbai land	3,100
Total	**71,100**

Source: DLF, Ambit Capital Research

DAL- no further sale planned to DAL

DLF has already sold 13mn sq. ft. or property to DAL and delivered 5mn sq ft of property till date. It expects to deliver another 3mn sq. ft. in FY10. The average rental rate for calculating the valuation of the property is Rs58/sq ft/month.

Exhibit 7: Profit and Loss

YE March (Rs mn)	FY07	FY08	FY09	FY10E	FY11E
Sales	**39,456**	**144,530**	**100,440**	**56,769**	**61,965**
Cost of Construction	7,278	39,998	33,330	26,471	30,854
Gross Profit	32,178	104,533	67,110	30,297	31,111
Salary	1,051	2,998	4,590	1,987	2,169
Other Expenses	3,148	4,229	7,640	8,022	8,423
EBIDTA	**27,979**	**97,306**	**54,880**	**20,288**	**20,519**
Depreciation	578	901	2,360	2,466	3,033
EBIT	27,401	96,406	52,520	17,822	17,486
Net Interest Expense	3,076	3,100	3,578	3,346	3,319
Other Income	1,077	2,309	4,974	3,823	5,223
Profit Before Tax	25,402	95,614	53,916	18,299	19,390
Tax	6,052	17,391	7,110	4,026	4,847
Net Profit	**19,350**	**78,223**	**46,806**	**14,273**	**14,542**
Minority & other Adj.	14	103	510	300	300
Adjusted Profit	**19,336**	**78,120**	**46,296**	**13,973**	**14,242**
Key Parameters					
Margins %					
EBIDTA Margin	70.9	67.3	54.6	35.7	33.1
Net Profit Margin	49.0	54.1	46.1	24.6	23.0
Growth (%YoY)					
Sales	134.6	266.3	-30.5	(43.5)	9.2
EBIDTA	190.0	247.8	(43.6)	(63.0)	1.1
Net Profit	173.1	304.0	(40.7)	(69.8)	1.9

Exhibit 8: Balance Sheet

YE March (Rs mn)	FY07	FY08	FY09	FY10E	FY11E
Equity Capital	12,557	12,905	17,350	17,335	17,335
Reserves & Surplus	22,992	183,977	230,850	243,431	254,264
Shareholders funds	35,549	196,883	248,200	260,766	271,599
Minority Interest	92	3,895	5,180	5,180	5,180
Loans	99,327	122,771	163,580	148,580	175,580
Deferred tax liability	197	359	(340)	(340)	(340)
Total capital employed	**135,165**	**323,907**	**416,620**	**414,186**	**452,019**
Gross block	18,044	51,626	73,550	77,535	98,794
Less: accu. Depreciation	2,412	3,435	5,950	8,416	11,449
Net Block	15,632	48,191	67,600	69,119	87,345
Capital WIP	26,219	51,840	69,560	87,622	105,836
Net Fixed assets	41,851	100,031	137,160	156,741	193,181
Goodwill	8,935	20,931	22,120	22,120	22,120
Investments	2,107	9,102	13,830	13,830	13,830
Current Assets	128,343	266,001	320,798	281,262	299,318
Inventories	56,799	94,544	113,368	114,072	117,692
Debtors	15,057	76,106	96,570	87,513	77,456
Cash and bank	4,155	21,421	11,980	5,416	36,537
Loans and advances	52,258	73,686	97,400	72,781	66,153
Other current assets	74	243	1,480	1,480	1,480
Current Liabilities	33,124	42,639	44,194	44,756	57,189
Creditors	2,678	17,046	23,589	11,935	13,311
Advance from customers	23,611	14,083	9,050	21,218	32,220
Others	6,835	11,511	11,555	11,604	11,658
Provisions	12,948	29,518	33,094	15,010	19,241
Net Current Assets	82,272	193,843	243,510	221,496	222,888
Total capital employed	**135,165**	**323,907**	**416,620**	**414,187**	**452,020**

Source: Company, Ambit Capital Research

Exhibit 9: Cash Flow

YE March (Rs mn)	FY07	FY08	FY09	FY10E	FY11E
Profit after tax	19,360	78,211	46,806	14,273	14,542
Depreciation	578	901	2,360	2,466	3,033
Other Adjustments	(1,088)	(2,399)	(5,484)	(4,123)	(5,523)
Operating Income	18,850	76,712	43,682	12,617	12,053
+ (Inc)/Dec in Debtors	(8,476)	(61,049)	(20,464)	9,057	10,056
+ (Inc)/Dec in Inventories	(40,390)	(37,745)	(18,824)	(704)	(3,621)
+ (Inc)/Dec in Loans & Advances	(41,616)	(21,428)	(23,714)	24,619	6,628
+ (Inc)/Dec in Other Assets	(51)	(169)	(1,237)	-	-
+ Inc/(Dec) in Current Liab.	18,029	9,516	1,555	562	12,433
+ Inc/(Dec) in Provisions	9,574	16,570	3,576	(18,084)	4,231
Operating cash flow	**(44,081)**	**(17,593)**	**(15,426)**	**28,067**	**41,781**
+ (Inc)/Dec in Capital Expenditure	(25,387)	(59,081)	(39,489)	(22,047)	(39,473)
+ (Inc)/Dec in Investments	6,193	(6,995)	(4,728)	-	-
+ (Inc)/Dec in Goodwill	(446)	(11,995)	(1,189)	-	-
Free Cash Flow	**(63,720)**	**(95,664)**	**(60,832)**	**6,020**	**2,308**
+ Increase in Equity Capital	2,584	90,733	576	(1,407)	-
+ Increase in Preference Capital	9,498	(2)	4,445	-	-
+ Inc/(Dec) in Long Term Loans	58,007	23,444	40,809	(15,000)	27,000
+ Other Income	1,077	2,309	4,974	3,823	5,223
+ Inc/(Dec) in Deferred Tax Liability	104	162	(699)	-	-
- Final Dividend	-	(3,990)	-	-	(3,410)
Total Cash Generated	**2,205**	**17,266**	**(9,441)**	**(6,564)**	**31,121**

Exhibit 10: Ratio Analysis

YE March	FY07	FY08	FY09	FY10E	FY11E
EBIDTA Margin (%)	70.9	67.3	54.6	35.7	33.1
EBIT Margin (%)	69.4	66.7	52.3	31.4	28.2
Net Profit Margin (%)	49.0	54.1	46.1	24.6	23.0
ROCE (%)	20.6	31.5	11.5	3.2	3.1
ROE (%)	108.3	71.9	21.5	5.7	5.5
Current ratio	2.8	3.7	4.2	4.7	3.9

Exhibit 11: Valuation Parameters

YE March	FY07	FY08	FY09	FY10E	FY11E
EPS (Rs)	12.7	45.9	27.5	8.4	8.6
Book Value per share (Rs)	23	115	146	154	160
P/E (x)	28.0	7.7	12.9	42.1	41.3
P/BV (x)	15.2	3.1	2.4	2.3	2.2
EV/EBITDA (x)	22.9	7.5	14.0	36.9	37.8
EV/Sales (x)	16.2	5.0	7.6	13.2	12.5

Source: Company, Ambit Capital Research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-Month period from date of initial rating)
Buy	>15%
Hold	5% to 15%
Sell	<5%

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