DLF DLFU IN

PROPERTY | INDIA

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Maintained

NEUTRAL

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Action

We met the management of DLF Ltd. DLF is likely to end 4QFY10 with sales of 3-3.5mn sqft, mainly mid-income housing which should result in lower revenues on a q-q basis. Office leasing will be in the range of 1-2mn sqft. Volumes in FY11 are likely to be driven by 4-6mn sqft of 'value housing' with mid-income and premium housing sales at FY10 levels. Operational cash flow will decide the extent of debt reduction in FY11 and hence execution is the key.

Catalysts

Our view might be more positive if DLF were to beat our volume estimates. Or, if recovery in office demand were sharper, prompting a value-accretive listing of a REIT.

Anchor themes

We believe that the residential recovery has so far been restricted to Mumbai and NCR. Assuming affordability, FY11F could be the year for a countrywide residential recovery, combined with recovering office space demand

Closing price on 26 Mar	Rs294.7
Price target	**Rs330.7**
	(set on 2 Feb 10)
Upside/downside	12.2%
Difference from consensus	**-2.7%**
FY11F net profit (Rsmn)	35,104
Difference from consensus	**26.7%**

Source: Nomura

Nomura vs consensus

Consensus is bullish on DLF Ltd., expecting a quick upturn in the office segment and hence listing of a REIT. We are more cautious on the stock.

Company visit update

① 4QFY10 revenues may decline on a QoQ basis

DLF is likely to end 4QFY10 with residential sales of 3-3.5mn sqft primarily driven by 2mn sqft sales in DLF Valley, Panchkula. About 70 apartments in Capital Greens Phase III in New Delhi have been sold till date at an average base price of INR11,000/sqft. Absence of large volumes from the Capital Greens project or other premium projects in 4QFY10 as in 9MFY10 can result in a q-q reduction in revenues

② Value housing to drive volumes in FY11

The company has not given any official guidance on the sales front but the focus would be on maintaining the same level of sales in the mid-income and city centre housing segments in FY11 as in FY10 which would be about 7mn sqft and 5mn sqft, respectively. The 'value housing' segment could add 4-6mn sqft of sales taking the total to 17-18mn sqft of residential sales in FY11, in-line with our estimates, though current demand trends suggest a downside to the same.

③ Debt reduction to depend on operational cash flow

DLF is no longer looking to sell its wind power business. Its non-core asset divestment target has been reduced by INR10bn to INR45bn. After selling INR20bn worth of assets till date in FY10, FY11 is likely to contribute INR25bn. These asset sales plus operational cash flow from an estimated 50mn sqft of under-construction residential projects will drive an INR60 bn reduction in gross debt in FY11. The REIT listing of DAL is on the cards but not in the medium term.

④ Maintain NEUTRAL as valuations fair

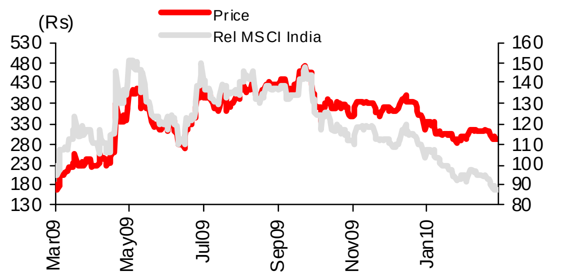
The stock is trading at a 9% discount to our NAV of INR331/share. Given the lack of any upcoming triggers and fair valuation, we maintain our NEUTRAL rating.

Key financials & valuations

31 Mar (Rsmn)	FY09	FY10F	FY11F	FY12F
Revenue	100,354	73,384	99,930	142,468
Reported net profit	44,696	18,009	35,104	59,654
Normalised net profit	44,696	18,009	35,104	59,654
Normalised EPS (Rs)	26.34	10.61	20.69	35.15
Norm. EPS growth (%)	(49.9)	(59.7)	94.9	69.9
Norm. P/E (x)	11.2	27.8	14.2	8.4
EV/EBITDA (x)	11.7	17.9	12.3	7.4
Price/book (x)	2.1	1.9	1.7	1.4
Dividend yield (%)	0.9	0.0	0.0	0.0
ROE (%)	20.4	7.2	12.7	18.4
Gearing (%)	33.6	27.4	22.4	16.9
Earnings revisions				
Previous norm. net profit		18,009	35,104	59,654
Change from previous (%)		-	-	-
Previous norm. EPS (Rs)		10.61	20.69	35.15

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(1.3)	(20.5)	(31.0)
Absolute (US$)	0.5	(18.0)	(26.8)
Relative to Index	(8.6)	(23.3)	(42.1)
Market cap (US$mn)			11,051
Estimated free float (%)			22.0
52-week range (Rs)			472.0/165.5
3-mth avg daily turnover (US$mn)			77.2
Stock borrowability			Hard
Major shareholders (%)			
KP Singh and related parties			78.0

Source: Company, Nomura estimates

Any authors named on this report are research analysts unless otherwise indicated.
See the important disclosures and analyst certifications on pages 6 to 9.

Drilling down

No upcoming triggers

We met with the management of DLF Ltd. to get an update on the progress in 4QFY10 and the future plans.

Updates on 4QFY10 operational performance

DLF has achieved sales of 2mn sqft of residential space in DLF Valley Panchkula near Chandigarh at an average price of INR2,500/sqft in 4QFY10 till date. Demand for this project from armed forces personnel and government employees was strong. It has also sold 50% of phase III of DLF Capital Greens (about 70 apartments) at an average base price of INR11,000/sqft which is 100% more than the average base price in phase I of the project launched in June 2009 and 60% higher than phase II launched in September 2009.

The company is likely to end 4QFY10 with a residential sales volume of 3-3.5mn sqft which would take the FY10 total residential sales volume to 11.5-12mn sqft. This would miss our estimate of 16mn sqft of residential sales for FY10.

On the office space front, DLF has pre-leased 1mn sqft in its non-DLF Assets Ltd. (DAL) portfolio in 4QFY10 and is in talks for leasing another 1mn sqft.

The overall residential sales for FY10 are likely to be 4.3mn sqft from DLF Capital Greens-New Delhi, 2mn sqft from DLF Phase V projects in Gurgaon, 2mn sqft from DLF New Town, Bangalore, 2mn sqft from the Panchkula project and the rest from ongoing projects in New Gurgaon, Chennai, Kolkata, etc.

Outlook on FY11: 'value' in housing, robust office leasing

The focus is likely to be on successfully launching 'value housing' projects in locations on the outskirts of large cities and in tier I & II towns. While the company has not given any official guidance on the sales front, the focus would be on maintaining the same level of sales in the mid-income and city centre housing segments in FY11 as in FY10. The value housing segment could add 4-6mn sqft of sales taking the total to 17-18mn sqft of residential sales in FY11. This is likely to be in-line with our estimate of 18mn sqft for FY11E though sales of commercial complexes and other commercial asset sales would determine if our overall sales target would be met. Given the flattening demand profile in most of the major cities in the last four to five months, we can see downward revisions in ours and the company's estimates.

Further city centre launches would be witnessed in Gurgaon (outside of phase V), Delhi, Chennai and Mumbai while Bangalore, Panchkula, Kochi, Hyderabad, Chennai, New Gurgaon may see further phases of existing mid-income projects being launched.

According to the management, the pickup in office space leasing has been slower than anticipated though general enquiries have increased. They see robust demand for office leasing in 2HFY11 if the economy stays strong. Project deliveries in FY11 are likely to be around 6mn sqft with another 10-12mn sqft in FY12.

Debt reduction strategies-dependent on operational cash flow

After the merger of DLF Cyber City with DAL and Caraf, the consolidated gross debt is likely to increase by about INR44bn from the 3QFY10 level of INR171bn, if the compulsory convertible preference shares (CCPS) in DAL are treated as equity. Our balance sheet estimates would need to be adjusted for the DAL merger once the treatment for the CCPS is clear.

The sale of the wind power business is now unlikely though DLF still targets non-core asset sales of INR20-25bn in FY11 with FY10 contributing close to INR20bn. With non-core asset sale of INR20bn, rental inflows of INR15bn, cash inflows from 18mn sqft of fresh residential sales in FY11 and cash inflows from the 33mn sqft of already under-construction projects, the company can reduce the gross debt by about INR60bn in FY11.

DAL REIT listing-not in a hurry

The merger of DAL-Caraf-DLF Cyber City has concluded in March 2010. The company is currently working on listing the leased DAL assets as a REIT but does not see this happening in the near to medium term.

Maintain NEUTRAL

The stock currently trades at a 9% discount to our net asset value of INR331/share. From our meeting with the management, we did not get the sense of any upcoming triggers which could help in re-rating the stock, unless the office space market improves faster than expectations leading to a REIT listing. We maintain a NEUTRAL rating with a target price of INR331 per share.

Valuation Methodology/Risk

We value DLF Ltd. using a Net Asset Value (NAV) methodology which is a DCF valuation of the development potential of the land reserves and developed property which the company holds. We do not offer any premium or discount to this NAV to arrive at our target price. Our NAV of INR331 per share is calculated using a 14% discount rate.

The upside risks are; 1) A faster than expected improvement in office segment leading to a value-accretive listing of office projects in a REIT; 2) Demand for housing showing a rapid upturn especially in the key location of Gurgaon.

The downside risks are: 1) rapid increases in interest rates; 2) below expectation growth in the economy; 3) execution lagging behind expectations; 4) a credit-crunch like environment resulting in developers unable to refinance their debt

Financial statements

Income statement (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Investment properties	2,800	6,044	7,732	8,706	10,477
Property development	139,487	84,802	61,895	86,714	126,580
Hotels/serviced apartments					
Other Revenue	2,652	9,509	3,758	4,509	5,411
Revenue	**144,939**	**100,354**	**73,384**	**99,930**	**142,468**
EBIT contributions					
Investment properties	2,240	4,835	6,185	6,965	8,382
Property development	97,145	48,676	25,769	38,491	63,053
Hotels/serviced apartments					
Other income					
Management expenses					
EBITDA	**100,170**	**55,901**	**34,583**	**48,348**	**74,615**
Depreciation and amortisation	(785)	(2,390)	(2,629)	(2,891)	(3,181)
EBIT	**99,385**	**53,511**	**31,954**	**45,456**	**71,435**
Net interest expense	(2,980)	(5,549)	(10,132)	(11,291)	(12,149)
Associates & JCEs					
Other income	-	3,960	1,567	7,580	12,435
Earnings before tax	**96,405**	**51,922**	**23,390**	**41,746**	**71,721**
Income tax	(17,534)	(6,754)	(5,381)	(6,642)	(12,066)
Net profit after tax	**78,871**	**45,168**	**18,009**	**35,104**	**59,654**
Minority interests	(303)	(472)	-	-	-
Other items					
Preferred dividends					
Normalised NPAT	**78,568**	**44,696**	**18,009**	**35,104**	**59,654**
Extraordinary items					
Reported NPAT	**78,568**	**44,696**	**18,009**	**35,104**	**59,654**
Dividends	(7,986)	(4,320)	-	-	-
Transfer to reserves	**70,582**	**40,377**	**18,009**	**35,104**	**59,654**
Valuation and ratio analysis					
FD normalised P/E (x)	6.4	11.2	27.8	14.2	8.4
FD normalised P/E at price target (x)	7.1	12.6	31.2	16.0	9.4
Reported P/E (x)	5.6	11.2	27.8	14.2	8.4
Dividend yield (%)	2.1	0.9	-	-	-
Price/cashflow (x)	na	na	15.1	16.4	8.8
Price/book (x)	1.9	2.1	1.9	1.7	1.4
EV/EBITDA (x)	6.0	11.7	17.9	12.3	7.4
EV/EBIT (x)	6.0	12.2	19.3	13.1	7.7
EBIT margin (%)	68.6	53.3	43.5	45.5	50.1
Effective tax rate (%)	18.2	13.0	23.0	15.9	16.8
Dividend payout (%)	10.2	9.7	-	-	-
ROA (pretax %)	36.2	12.7	6.9	9.8	14.9
Growth (%)					
Revenue	450.2	(30.8)	(26.9)	36.2	42.6
EBITDA	573.8	(44.2)	(38.1)	39.8	54.3
EBIT	595.6	(46.2)	(40.3)	42.3	57.2
Normalised EPS	241.8	(49.9)	(59.7)	94.9	69.9
Normalised FDEPS	200.9	(43.1)	(59.7)	94.9	69.9
Per share					
Reported EPS (Rs)	52.6	26.3	10.6	20.7	35.2
Norm EPS (Rs)	52.6	26.3	10.6	20.7	35.2
Fully diluted norm EPS (Rs)	46.3	26.3	10.6	20.7	35.2
Book value per share (Rs)	152.6	142.3	152.9	173.6	208.8
DPS (Rs)	6.2	2.5	-	-	-

Source: Nomura estimates

Increase in volumes and possible sale of commercial space to support revenues

Cashflow (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	100,170	55,901	34,583	48,348	74,615
Change in working capital	(93,563)	(54,284)	21,800	0	0
Other operating cashflow	(12,875)	(15,011)	(23,323)	(17,888)	(17,707)
Cashflow from operations	**(6,268)**	**(13,394)**	**33,060**	**30,460**	**56,908**
Capital expenditure	(58,977)	(32,488)	(8,786)	(9,044)	(11,544)
Free cashflow	**(65,245)**	**(45,882)**	**24,273**	**21,415**	**45,364**
Reduction in investments					
Net acquisitions				-	-
Reduction in other LT assets	(18,999)	(6,635)	9,000	-	-
Addition in other LT liabilities	172	(773)	-	-	-
Adjustments	9,362	3,333	-	-	-
Cashflow after investing acts	**(74,710)**	**(49,957)**	**33,273**	**21,415**	**45,364**
Cash dividends	(7,986)	(4,320)	-	-	-
Equity issue	76,946	-	-	-	-
Debt issue	23,017	44,811	(35,000)	(20,000)	(20,000)
Convertible debt issue					
Others					
Cashflow from financial acts	**91,977**	**40,491**	**(35,000)**	**(20,000)**	**(20,000)**
Net cashflow	**17,267**	**(9,466)**	**(1,727)**	**1,415**	**25,364**
Beginning cash	4,155	21,422	11,956	10,230	11,645
Ending cash	21,422	11,956	10,230	11,645	37,009
Ending net debt	100,666	151,245	117,971	96,556	51,192

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	21,422	11,956	10,230	11,645	37,009
Properties held for sale	83,876	98,511	76,711	76,711	76,711
Accounts receivable	82,825	84,693	84,693	84,693	84,693
Other current assets	78,270	121,454	121,454	121,454	121,454
Total current assets	**266,393**	**316,614**	**293,088**	**294,503**	**319,867**
Investment properties	51,840	83,822	95,055	104,012	113,098
Other fixed assets (net)	44,153	48,150	52,452	57,184	62,389
Associates					
Other LT assets	30,041	36,676	27,676	27,676	27,676
Total assets	**392,427**	**485,263**	**468,271**	**483,375**	**523,031**
Short-term debt					
Accounts payable	46,760	52,963	52,963	52,963	52,963
Other current liabilities	22,438	21,639	21,639	21,639	21,639
Total current liabilities	**69,198**	**74,601**	**74,601**	**74,601**	**74,601**
Long-term debt	122,088	163,201	128,201	108,201	88,201
Convertible debt					
Other LT liabilities	359	(414)	(414)	(414)	(414)
Total liabilities	**191,645**	**237,389**	**202,388**	**182,388**	**162,388**
Minority interest	3,900	6,336	6,336	6,336	6,337
Preferred stock					
Shareholders' Equity	196,882	241,538	259,547	294,651	354,305
Other equity and reserves					
Total shareholders' equity	**196,882**	**241,538**	**259,547**	**294,651**	**354,305**
Total equity & liabilities	**392,427**	**485,263**	**468,271**	**483,375**	**523,031**
Leverage					
Interest cover	33.4	9.6	3.2	4.0	5.9
Gross debt/property assets (%)	31.1	33.6	27.4	22.4	16.9
Net debt/EBITDA (x)	1.00	2.71	3.41	2.00	0.69
Net debt/equity (%)	51.1	62.6	45.5	32.8	14.4
Dupont decomposition					
Net margin (%)	54.2	44.5	24.5	35.1	41.9
Asset utilisation (x)	0.5	0.2	0.2	0.2	0.3
ROA (%)	27.4	10.2	3.8	7.4	11.9
Leverage (Assets/Equity x)	2.4	2.0	1.9	1.7	1.6
ROE (%)	66.4	20.4	7.2	12.7	18.4

Source: Nomura estimates

Balance sheet to look better in terms of debt: equity ratio as cashflow from operations increase while non-core asset sales also help, though numbers are yet to reflect effect of merger with DAL

ANALYST CERTIFICATIONS

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
DLF	DLFU IN	299.15 INR	29 Mar 2010	Neutral	

Previous Ratings

Issuer	Previous Rating	Date of change
DLF	Reduce	02 Feb 2010

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The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to price target defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

Stocks:

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• A rating of "3", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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Benchmarks are as follows: **United States:** S&P 500; **Europe:** Dow Jones STOXX® 600; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

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Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Price Target – Current Price) / Current Price, subject to limited management discretion. In most cases, the Price Target will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.
• A "**Buy**" recommendation indicates that potential upside is 15% or more.
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• A "**Reduce**" recommendation indicates that potential downside is 5% or more.
• A rating of "**RS**" or "**Rating Suspended**" indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.
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Stocks:

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• A rating of "3", or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
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A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.
A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.
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Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

- A "**Strong buy**" recommendation indicates that upside is more than 20%.
- A "**Buy**" recommendation indicates that upside is between 10% and 20%.
- A "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A "**Reduce**" recommendation indicates that downside is between 10% and 20%.
- A "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

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