# Unitech UNTE.NS UT IN

PROPERTY

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EQUITY RESEARCH

At distressed liquidation value

# 2G telecom scam remains overhang, but property business does have value

September 22, 2011

| | |
|---|---|
| **Rating** Remains | **Buy** |
| **Target price** Reduced from 64 | INR 42 |
| **Closing price** September 20, 2011 | INR 29 |
| **Potential upside** | +44.8% |

### Action: Cutting estimates; maintain BUY on very cheap valuations

Unitech's stock is trading at distressed liquidation value given concerns on corporate governance amid its alleged involvement in the 2G telecom scam. While we acknowledge that this issue will remain an overhang on the stock and that the stock may make a substantial positive move only after a resolution, the real estate business does have value. The distressed liquidation value for its top six land holdings is INR29 per share, on our estimate. Free cash flow pre-interest cost turned positive in FY11, and we expect it to be positive even after interest cost in FY12F, which should be encouraging. Recent newsflow suggests a weakening of the telecom scam case against Unitech, though we consider it still too early to draw any conclusion about the outcome. We have cut our SOTP value to INR52 from INR64 earlier on slowing sales and weaker margins and apply a 20% discount to our NAV of INR49, in-line with the past four years' average discount, to arrive at our target price of INR42.

### Catalysts: Positive outcome of telecom issue, cash flow generation

The biggest catalyst, in our view, would be any positive outcome for Unitech from the 2G telecom case, positive free cash flow generation post interest cost and a halt to the monetary tightening in India.

### Valuation: Stock trading at 45% discount to NAV

We have revised our NAV downwards to INR49 per share from INR59 per share earlier, and value Unitech Infra at INR3 per share. We apply a 20% discount to NAV, which is in-line with the last four years' average discount to arrive at our new target price of INR42 per share. The stock is trading at 0.6x FY13F P/B. ROE will likely remain low given high land holdings.

| 31 Mar | FY11 | | FY12F | | FY13F | | FY14F |
|---|---|---|---|---|---|---|---|
| Currency (INR) | Actual | Old | New | Old | New | Old | New |
| **Revenue (mn)** | 32,355 | 33,500 | 31,812 | 41,622 | 36,383 | | 37,617 |
| **Reported net profit (mn)** | 5,677 | 7,358 | 5,393 | 9,050 | 6,232 | | 6,342 |
| **Normalised net profit (mn)** | 5,677 | 7,358 | 5,393 | 9,050 | 6,232 | | 6,342 |
| **Normalised EPS** | 2.17 | 2.81 | 2.06 | 3.46 | 2.38 | | 2.42 |
| **Norm. EPS growth (%)** | -15.9 | 15.3 | -5.0 | 23.0 | 15.6 | | 1.8 |
| **Norm. P/E (x)** | 13.2 | N/A | 13.9 | N/A | 12.0 | | 11.8 |
| **EV/EBITDA (x)** | 13.9 | 9.9 | 13.5 | 7.2 | 10.9 | | 9.7 |
| **Price/book (x)** | 0.6 | N/A | 0.6 | N/A | 0.6 | | 0.6 |
| **Dividend yield (%)** | 0.7 | N/A | na | N/A | na | | na |
| **ROE (%)** | 5.2 | 6.1 | 4.5 | 6.8 | 5.0 | | 4.8 |
| **Gearing (%)** | 18.2 | 17.7 | 16.9 | 15.5 | 15.1 | | 13.1 |

Source: Nomura estimates

**Key company data:** *See page 2 for company data and detailed price/index chart.*
**Rating:** *See report end for details of Nomura's rating system.*

### Anchor themes

CY12 is likely to be a difficult year for residential volumes if prices do not correct by 15-20%. A correction in prices could bring back buyer interest in both property and property stocks. Corporate governance is top of the mind for investors too.

### Nomura vs consensus

Our FY12 and FY13 EPS estimates are 20% and 28% below consensus estimates since we build in lower volume and margin estimates.


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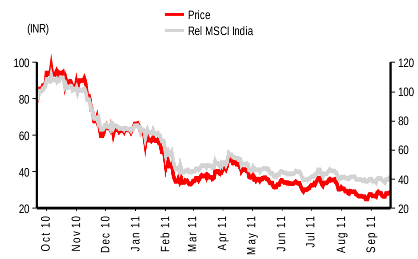
# Key data on Unitech

## Income statement (INRmn)

| Year-end 31 Mar | FY10 | FY11 | FY12F | FY13F | FY14F |
|---|---|---|---|---|---|
| Investment properties | 440 | 645 | 781 | 1,238 | 1,918 |
| Property development | 23,214 | 26,176 | 26,954 | 30,945 | 31,364 |
| Hotels/serviced apartments | | | | | |
| Other Revenue | 5,990 | 5,534 | 4,077 | 4,200 | 4,335 |
| Revenue | 29,644 | 32,355 | 31,812 | 36,383 | 37,617 |
| EBIT contributions | | | | | |
| Investment properties | | | | | |
| Property development | 10,371 | 8,920 | 8,917 | 10,605 | 11,211 |
| Hotels/serviced apartments | | | | | |
| Other income | | | | | |
| Management expenses | | | | | |
| EBITDA | 10,712 | 9,239 | 9,371 | 11,165 | 11,873 |
| Depreciation and amortisation | -341 | -319 | -453 | -560 | -661 |
| EBIT | 10,371 | 8,920 | 8,917 | 10,605 | 11,211 |
| Net interest expense | -2,000 | -1,455 | -1,997 | -2,849 | -3,555 |
| Associates & JCEs | | | | | |
| Other income | 840 | 1,050 | 1,012 | 1,367 | 1,629 |
| Earnings before tax | 9,210 | 8,516 | 7,932 | 9,123 | 9,285 |
| Income tax | -2,264 | -2,704 | -2,439 | -2,741 | -2,719 |
| Net profit after tax | 6,947 | 5,812 | 5,493 | 6,382 | 6,567 |
| Minority interests | -196 | -135 | -100 | -150 | -225 |
| Other items | | | | | |
| Preferred dividends | | | | | |
| Normalised NPAT | 6,751 | 5,677 | 5,393 | 6,232 | 6,342 |
| Extraordinary items | | | | | |
| Reported NPAT | 6,751 | 5,677 | 5,393 | 6,232 | 6,342 |
| Dividends | -489 | -523 | | | |
| Transfer to reserves | 6,262 | 5,153 | 5,393 | 6,232 | 6,342 |
| | | | | | |
| Valuation and ratio analysis | | | | | |
| FD normalised P/E (x) | 11.1 | 13.2 | 13.9 | 12.0 | 11.8 |
| FD normalised P/E at price target (x) | 16.3 | 19.4 | 20.4 | 17.6 | 17.3 |
| Reported P/E (x) | 11.1 | 13.2 | 13.9 | 12.0 | 11.8 |
| Dividend yield (%) | 0.7 | 0.7 | na | na | na |
| Price/cashflow (x) | na | 7.2 | 5.9 | 4.8 | 4.9 |
| Price/book (x) | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 |
| EV/EBITDA (x) | 12.2 | 13.9 | 13.5 | 10.9 | 9.7 |
| EV/EBIT (x) | 12.6 | 14.4 | 14.2 | 11.4 | 10.3 |
| EBIT margin (%) | 35.0 | 27.6 | 28.0 | 29.1 | 29.8 |
| Effective tax rate (%) | 24.6 | 31.8 | 30.8 | 30.0 | 29.3 |
| Dividend payout (%) | 7.2 | 9.2 | 0.0 | 0.0 | 0.0 |
| ROA (pretax %) | 3.9 | 3.0 | 2.8 | 3.3 | 3.5 |
| | | | | | |
| Growth (%) | | | | | |
| Revenue | 1.3 | 9.1 | -1.7 | 14.4 | 3.4 |
| EBITDA | -32.6 | -13.8 | 1.4 | 19.2 | 6.3 |
| EBIT | -33.9 | -14.0 | 0.0 | 18.9 | 5.7 |
| Normalised EPS | -47.3 | -15.9 | -5.0 | 15.6 | 1.8 |
| Normalised FDEPS | -65.0 | -16.0 | -5.0 | 15.6 | 1.8 |
| | | | | | |
| Per share | | | | | |
| Reported EPS (INR) | 2.58 | 2.17 | 2.06 | 2.38 | 2.42 |
| Norm EPS (INR) | 2.58 | 2.17 | 2.06 | 2.38 | 2.42 |
| Fully diluted norm EPS (INR) | 2.58 | 2.17 | 2.06 | 2.38 | 2.42 |
| Book value per share (INR) | 42.57 | 44.27 | 46.37 | 48.81 | 51.32 |
| DPS (INR) | 0.20 | 0.20 | 0.00 | 0.00 | 0.00 |

Source: Nomura estimates

### Price and price relative chart (one year)




| (%) | 1M | 3M | 12M |
|---|---|---|---|
| Absolute (INR) | 7.5 | -11.6 | -67.5 |
| Absolute (USD) | 2.4 | -17.2 | -69.1 |
| Relative to index | 0.6 | -8.8 | -51.6 |
| Market cap (USDmn) | 1,557.2 | | |
| Estimated free float (%) | 51.5 | | |
| 52-week range (INR) | 101/25 | | |
| 3-mth avg daily turnover (USDmn) | 19.33 | | |
| Major shareholders (%) | | | |
| Chandra family | 48.5 | | |

## Cashflow (INRmn)

| Year-end 31 Mar | FY10 | FY11 | FY12F | FY13F | FY14F |
|---|---|---|---|---|---|
| EBITDA | 10,712 | 9,239 | 9,371 | 11,165 | 11,873 |
| Change in working capital | -15,251 | -11,861 | 6,000 | 7,000 | 6,000 |
| Other operating cashflow | 3,735 | 12,946 | -2,711 | -2,591 | -2,494 |
| Cashflow from operations | -805 | 10,324 | 12,659 | 15,575 | 15,379 |
| Capital expenditure | -5,121 | -3,244 | -1,366 | -1,956 | -2,896 |
| Free cashflow | -5,925 | 7,080 | 11,293 | 13,619 | 12,483 |
| Reduction in investments | 4,628 | 1,960 | 0 | 0 | 0 |
| Net acquisitions | | | | | |
| Reduction in other LT assets | -8,727 | -2,678 | 0 | 0 | 0 |
| Addition in other LT liabilities | | | | | |
| Adjustments | 840 | 1,050 | 1,012 | 1,367 | 1,629 |
| Cashflow after investing acts | -9,185 | 7,412 | 12,305 | 14,986 | 14,112 |
| Cash dividends | -607 | -587 | 0 | 0 | 0 |
| Equity issue | 48,074 | 6,541 | 0 | 0 | 0 |
| Debt issue | -30,481 | -1,942 | -3,500 | -5,500 | -6,500 |
| Convertible debt issue | | | | | |
| Others | -10,451 | -10,713 | -10,732 | -9,414 | -7,829 |
| Cashflow from financial acts | 6,535 | -6,702 | -14,232 | -14,914 | -14,329 |
| Net cashflow | -2,650 | 711 | -1,927 | 72 | -216 |
| Beginning cash | 6,449 | 3,800 | 4,510 | 2,584 | 2,655 |
| Ending cash | 3,800 | 4,510 | 2,584 | 2,655 | 2,439 |
| Ending net debt | 56,278 | 53,997 | 52,052 | 46,480 | 40,196 |

Source: Nomura estimates

## Balance sheet (INRmn)

| As at 31 Mar | FY10 | FY11 | FY12F | FY13F | FY14F |
|---|---|---|---|---|---|
| Cash & equivalents | 3,800 | 4,510 | 2,584 | 2,655 | 2,439 |
| Properties held for sale | 164,160 | 186,270 | 183,770 | 181,270 | 178,770 |
| Accounts receivable | 12,671 | 21,475 | 17,975 | 13,475 | 9,975 |
| Other current assets | 39,421 | 41,930 | 41,930 | 41,930 | 41,930 |
| Total current assets | 220,051 | 254,185 | 246,258 | 239,330 | 233,114 |
| Investment properties | 45 | 46 | 45 | 45 | 45 |
| Other fixed assets (net) | 33,581 | 34,728 | 44,375 | 52,336 | 58,844 |
| Associates | | | | | |
| Other LT assets | 29,987 | 32,665 | 32,665 | 32,665 | 32,665 |
| Total assets | 283,664 | 321,624 | 323,344 | 324,376 | 324,668 |
| Short-term debt | | | | | |
| Accounts payable | 101,209 | 122,772 | 122,772 | 122,772 | 122,772 |
| Other current liabilities | | | | | |
| Total current liabilities | 101,209 | 122,772 | 122,772 | 122,772 | 122,772 |
| Long-term debt | 60,078 | 58,507 | 54,635 | 49,135 | 42,635 |
| Convertible debt | | | | | |
| Other LT liabilities | 17,953 | 24,020 | 24,020 | 24,020 | 24,020 |
| Total liabilities | 179,241 | 205,299 | 201,427 | 195,927 | 189,427 |
| Minority interest | 373 | 489 | 589 | 739 | 964 |
| Preferred stock | 0 | 0 | 0 | 0 | |
| Shareholders' Equity | 4,878 | 5,233 | 5,233 | 5,233 | 5,233 |
| Other equity and reserves | 99,173 | 110,604 | 116,097 | 122,479 | 129,046 |
| Total shareholders' equity | 104,050 | 115,836 | 121,329 | 127,711 | 134,278 |
| Total equity & liabilities | 283,664 | 321,624 | 323,345 | 324,377 | 324,669 |
| | | | | | |
| Leverage | | | | | |
| Interest cover | 5.19 | 6.13 | 4.47 | 3.72 | 3.15 |
| Gross debt/property assets (%) | 21.2 | 18.2 | 16.9 | 15.1 | 13.1 |
| Net debt/EBITDA (x) | 5.3 | 5.8 | 5.6 | 4.2 | 3.4 |
| Net debt/equity (%) | 54.1 | 46.6 | 42.9 | 36.4 | 29.9 |
| | | | | | |
| Dupont decomposition | | | | | |
| Net margin (%) | 22.8 | 17.5 | 17.0 | 17.1 | 16.9 |
| Asset utilisation (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| ROA (%) | 2.5 | 1.9 | 1.7 | 1.9 | 2.0 |
| Leverage (Assets/Equity x) | 3.5 | 2.8 | 2.7 | 2.6 | 2.5 |
| ROE (%) | 8.67 | 5.16 | 4.55 | 5.00 | 4.84 |

Source: Nomura estimates

## Why are we maintaining a BUY on Unitech

There continues to be a lot of negativity surrounding the stock emanating from the 2G telecom scam involvement and the fact that the company's MD, Mr. Sanjay Chandra is still under arrest for the same.

At this point though, with the stock down 67% in the past one year vs. a 13% fall in the BSE Sensex and a 51% fall in the BSE Realty Index, we believe the negative impact is being factored in. If we take the land holdings of Unitech in its top six geographies and attribute a distressed sale price to them, then on our estimate the stock is trading below its distressed liquidation value.

**Fig. 1: Liquidation value of the company from the top six land holdings**

| | Land (mn sqft) | INR/sqft | INR mn |
|---|---|---|---|
| Gurgaon | 75 | 1,000 | 75,000 |
| Noida+Gr. Noida | 45 | 500 | 22,500 |
| Chennai | 90 | 250 | 22,500 |
| Kolkata | 26 | 250 | 6,500 |
| Hyderabad | 55 | 200 | 11,000 |
| Mohali | 34 | 500 | 17,000 |
| **Total** | **325** | **475** | **154,500** |
| minus-Net debt | | | 53,625 |
| minus- Land payment | | | 23,964 |
| **Liquidation value** | | | **76,911** |
| **Per share (INR)** | | | **29** |

Source: Nomura estimates

In terms of cash flow too, the company turned free cash flow positive pre-interest cost in FY11 and we expect it to turn free cash flow positive in FY12F post interest cost as projects launched in the past 6-12 months come under construction while older projects get delivered and some debtors on account of those projects get liquidated. The cash flow will likely also be helped by the fact that the company plans to sell some of its long gestation assets like land, hotels, IT parks and SEZs. While we do not expect any significant movement in selling off IT parks and SEZs unless done at a very low valuation, we expect the company to sell INR7.5bn worth of land over the next three years, which should be easily done, in our view. Unitech MD Mr. Ajay Chandra has said that the company would raise INR3-4bn in FY12F by selling land parcels in cities like Thiruvananthapuram.

For FY12F, while the company has already refinanced INR5.5bn of the INR11bn of debt to be repaid, we do not expect any significant reduction of debt as free cash flow post interest cost will likely be a very small positive value. It is only from FY13F that we expect the company to increase the pace of debt repayment.

**Fig. 2: Reduction in debt level from operational cash flows**

| | FY12F | FY13F | FY14F |
|---|---|---|---|
| Cash flow from operations | 12,559 | 15,425 | 15,154 |
| Capex | (1,366) | (1,956) | (2,896) |
| **Free cash flow** | **11,193** | **13,469** | **12,258** |
| Net interest expense | (9,720) | (8,047) | (6,200) |
| others | 100 | 150 | 225 |
| **Cash surplus** | **1,573** | **5,572** | **6,284** |
| Beginning cash | 4,510 | 2,584 | 2,655 |
| **Debt repayment** | **(3,500)** | **(5,500)** | **(6,500)** |
| **Ending cash** | 2,584 | 2,655 | 2,439 |

Source: Nomura estimates

We acknowledge the fact that the telecom scam and the possible involvement of Unitech and Mr. Sanjay Chandra will continue to be an overhang on the stock, and in our view only post a resolution or at least granting of bail for Mr. Chandra would the stock make a substantial positive move. If we consider INR53 per share as the fair value for the stock, then at the current stock price, the market is attributing an INR64bn financial penalty on the company. This seems excessive to us given that the key point of contention is the difference between the valuation at which Telenor bought a 67.25% stake in Unitech and the license fee paid by Unitech, which is INR73bn; 88% of this difference cannot be attributed to Unitech's 32.75% stake as a penalty.

## Recent newsflow on the 2G telecom scam suggests weakening of the case against Unitech

While it is still too early to comment on how this will play out, recent newsflow has been a bit positive for Unitech as far as the 2G telecom scam is concerned.

As per a report in Hindustan Times *('Can't trace Unitech money trail, says CBI', 30th Aug 2011)*, the CBI has informed the special court hearing the case that it could not find evidence against Unitech Wireless (Tamil Nadu) Pvt. Ltd. to show any money trail as a quid pro quo for grant of 2G spectrum licences. It continues though to maintain charges of criminal conspiracy against the company for having been allotted telecom licenses when it was not eligible for the same, as per the rules.

In a news report in Economic Times *('2G Scam: Apex Court tells CBI to produce TRAI's report, 6th Sep 2011)*, the Supreme Court of India, which was hearing the bail plea of Mr. Sanjay Chandra, has asked the CBI to place on record the report from the Telecom Regulatory Authority of India (TRAI), which said there was no loss to the public exchequer in the allotment of 2G spectrum by the then telecom minister A Raja in 2008.

In another report in The Times of India *('Telcos didn't divest shares', 13th Sep, 2011)*, the Central Board of Direct Taxes (CBDT) said that the infusion of foreign investment in telecom firms by issue of fresh shares does not amount to a transfer under the IT Act. It has argued with regard to equity sale to foreign investors, "issue of additional (new) share capital to Telenor does not amount to transfer of shares".

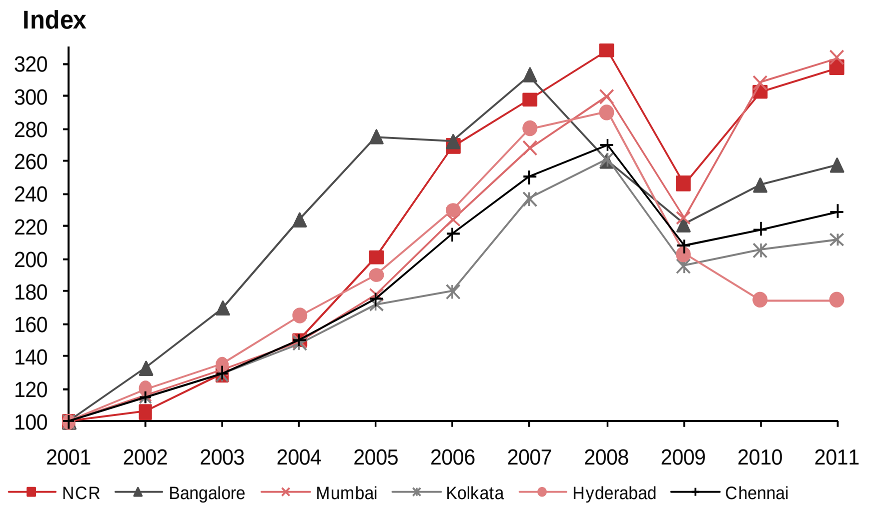
From the above, it looks like comments from government agencies regarding lack of evidence of any kickbacks, lack of any loss caused to the exchequer and issuing fresh equity to foreign telecom operators not amounting to transfer of shares has weakened the case against Unitech. Still, in our view, it is early days yet and a final conclusion cannot be drawn from this.

## Why are we cutting our target price

Unitech's sales volumes have slowed down to the 2mn sqft range over the past four quarters despite the company launching 25 new projects spread over 7.4mn sqft in 4QFY11 and 1QFY12. In terms of sales value, the same has been stuck in a range of INR10bn for the past one year. With mortgage rates higher by 300bps over the past 18 months and prices in most markets, especially Gurgaon, at new highs, it will get incrementally difficult for Unitech to increase the pace of sales, in our view.

About 64% of Unitech's cumulative sales volumes since Jun 2009 came from the National Capital Region (NCR), 47% from Gurgaon and another 17% from Noida/Greater Noida. With prices reaching new highs in Gurgaon, sales volumes for Unitech have dropped off over the past one year, while we believe the agitation by farmers in Noida/Greater Noida regarding land acquired for property development has led to buyers staying away till a resolution is achieved. Thus, Unitech's two major markets are likely to go through a slow phase, we expect.

**Fig. 3: Residential capital value trend in top six cities**




Source: NHB, Nomura research

**Fig. 4: Area sold each quarter (in mn sq ft)**

| | Area sold each quarter (mn sq ft) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Dec'09 | Mar'10 | Jun'10 | Sep'10 | Dec'10 | Mar'11 | Jun'11 | CY10 | 1HCY11 |
| Gurgaon | 1.2 | 2 | 1.4 | 1.2 | 1.0 | 0.8 | 0.5 | 5.6 | 1.3 |
| Noida + Gr. Noida | 0.7 | 0.4 | 0.7 | 0.4 | 0.5 | 0.3 | 0.2 | 1.9 | 0.5 |
| Chennai | 0.1 | 0.2 | 0.4 | 0.1 | 0.2 | 0.3 | 0.6 | 0.9 | 0.9 |
| Mumbai | 0.4 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | - |
| Kolkata | 0.1 | 0.1 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.9 | 0.4 |
| Other cities | 0.5 | 0.4 | 0.2 | 0.1 | 0.3 | 0.4 | 0.5 | 1.0 | 0.9 |
| **Total** | **3.0** | **3.4** | **3.0** | **2.0** | **2.2** | **2.0** | **1.9** | **10.6** | **3.9** |
| **NCR as % of total** | **63%** | **71%** | **71%** | **76%** | **67%** | **56%** | **34%** | **71%** | **45%** |

Source: Company data, Nomura research

The good news is that the company seems to have realised the same and is now focusing on other markets like Chennai, Bangalore, Mohali and some tier 2 and 3 towns like Lucknow, Bhopal, Mysore, Kochi, Ambala, Rewari, etc. About 54% of Unitech's new launches in 4QFY11 and 1QFY12 are in these new locations. Sales in the Jun 2011 quarter from the NCR region have now dropped to 37% of the quarter's overall sales volumes. Having said this, given the smaller size of the property market in these other cities, they will not be able to completely compensate for the lower sales in NCR and Unitech's volumes are unlikely to show any significant increase, in our view.

We have cut our volumes estimates by 20-30% for the next 2-3 years, as shown below. Also driven by Unitech's slow pace of execution and land reserves which are mainly on the outskirts of the city and towns, we have pushed back our peak year of development for the land reserves of 360mn sqft to FY23 from FY19 earlier.

**Fig. 5: Changes in sales volume estimates**

| | FY12F | | FY13F | | FY14F | |
|---|---|---|---|---|---|---|
| | Earlier | Now | Earlier | Now | Earlier | Now |
| Plots | 1.7 | 0.6 | 2 | 1.3 | 3.3 | 1.6 |
| Residential | 7 | 6.1 | 7 | 5.0 | 9.0 | 5.6 |
| Commercial | 1.1 | 0.8 | 1.1 | 0.9 | 1.5 | 1.0 |
| Retail | 0.6 | 1.01 | 1.9 | 1.01 | 3.1 | 1.2 |
| **Total** | **10.4** | **8.4** | **12** | **8.2** | **16.9** | **9.4** |

Source: Nomura estimates

**Fig. 6: Changes in volume estimates for deriving cash flows**

| | FY12F | | FY13F | | FY14F | |
|---|---|---|---|---|---|---|
| | Earlier | Now | Earlier | Now | Earlier | Now |
| Plots | 1.7 | 0.6 | 2 | 1.3 | 3.3 | 1.6 |
| Residential | 7.1 | 6.5 | 8.4 | 7.1 | 8.9 | 6.5 |
| Commercial | 0.7 | 0.7 | 1 | 0.9 | 1.2 | 1.0 |
| Retail | 0.3 | 0.49 | 0.8 | 0.67 | 1.6 | 0.9 |
| **Total** | **9.8** | **8.2** | **12.2** | **9.9** | **9.9** | **10.0** |

Source: Nomura estimates

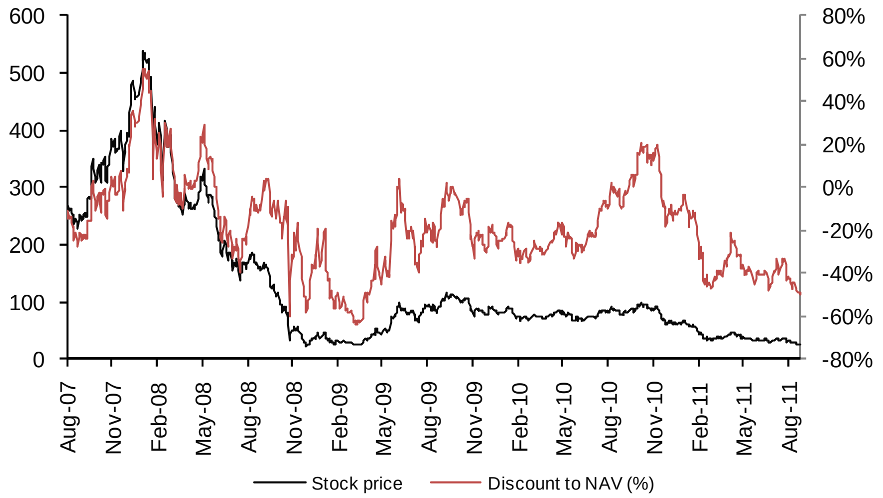
The property sector has also faced increasing construction costs, which have impacted margins of developers over the past 18 months. Inputs like steel and cement are up 15-20% over the last 18 months as per data from CEIC, while labour costs have also gone up 25-30% on our estimates. Unitech has also disappointed the market as far as its operating margins are concerned with margins down 700bps y-y. This has been partly driven by increased construction cost on some of its older projects launched between 2005 and 2008 where revenue recognition based on the percentage completion method (POCM) was done earlier at lower costs but as costs started increasing, they had to consider the retrospective impact of the same in subsequent quarters. The other factor which has led to a drop in margins is the impact from the shift towards lower priced mid-income projects where margins are lower than high-end projects. The third factor which has hit margins is the launch of several projects in FY10 at low prices where construction costs have since shot up, significantly cutting the profitability of such projects.

We have increased our cost of construction estimates by 20%, which impacts our operating margin outlook for the company by 800bps.

These changes have impacted our NAV by 19%, which falls from INR59 per share to INR49 per share. We have also reduced the value of Unitech Infra — which holds some land parcels for industrial park development, a 40% stake in Unitech Corporate Park's 5 SEZs and 1 IT park, amusement parks and retail space within them, hotels, construction business and transmission tower business — from INR5 per share to INR3 per share as the business case for them has worsened, too, with the management currently focusing on the real estate business and on its troubles surrounding the 2G telecom scam. We assign no value to the 32.75% stake in Unitech Wireless given the lack of clarity surrounding the validity of the license, which has been questioned by the Central Bureau of Investigation (CBI).

We apply a 20% discount to NAV in line with the historical discount at which it has traded for the past four years to arrive at our target price of INR42 per share, which implies potential upside of 45%.

**Fig. 7: Unitech price and discount to NAV chart (%)**




Source: Bloomberg, Nomura estimates

The stock is trading at a 45% discount to our revised NAV plus Unitech Infra value and at 0.6x FY13F P/B, which looks attractive. We believe the market will find this attractive too once there is a resolution to the 2G telecom scam. Also, when the monetary tightening regime in India eventually starts easing (our economists expect inflation and interest rates to peak in the next few months), we expect the value in the real estate business will start to become more apparent and the contribution of scam-related newsflow in determining stock price will decrease.

**Fig. 8: 1yr fwd NAV and target price**

| | INR mn (as of Sep'12) | INR/share (as of Sep'12) |
|---|---|---|
| **Real Estate NAV** | 127,044 | 49 |
| **Discount to NAV** | 20% | 10 |
| **Post discount real estate value** | 101,636 | 39 |
| **Unitech Infra** | 9,020 | 3 |
| **Target price** | **136,065** | **42** |
| **Upside** | | 44.8% |

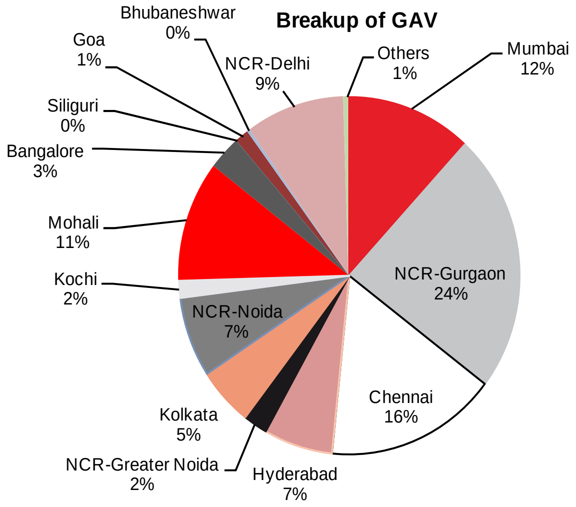
Source: Nomura estimates

**Fig. 9: Sensitivity to target price**

| For 1% decrease in | Change in per share value |
|---|---|
| WACC | 9% |
| Price growth | -21% |
| Commercial cap rate | 7% |
| Retail cap rate | 3% |

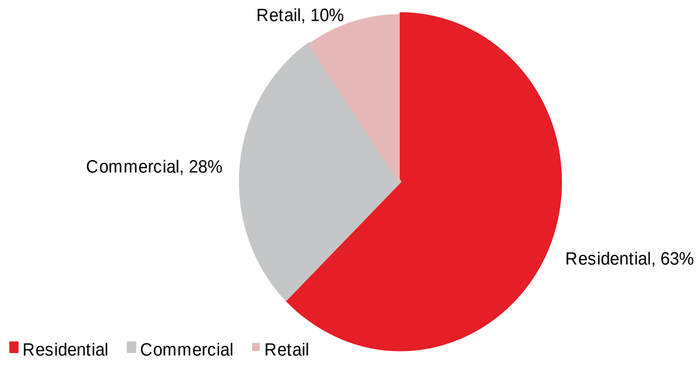
Source: Nomura estimates

**Fig. 10: Geographical split — One-year forward GAV estimate**




Source: Nomura estimates

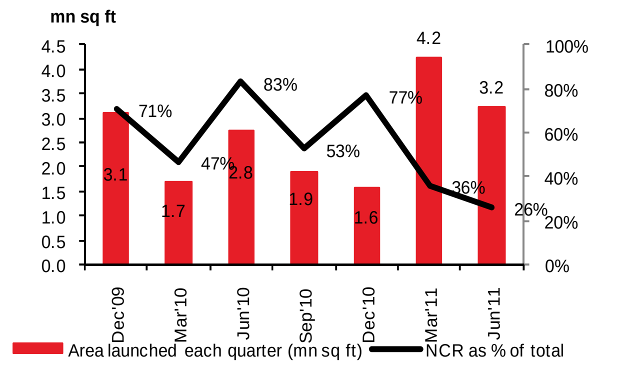
**Fig. 11: Asset split — One-year forward GAV estimate**




Source: Nomura estimates

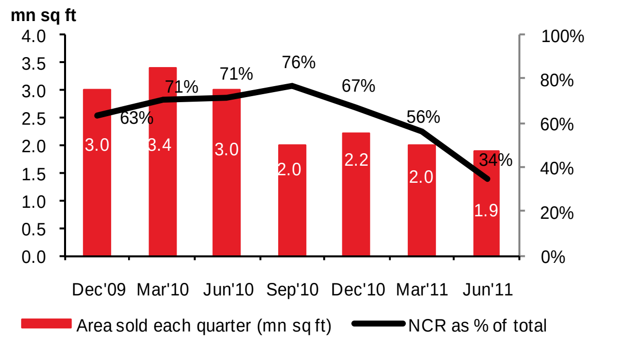
# Operational details for the property business

### Fig. 12: Total area launched



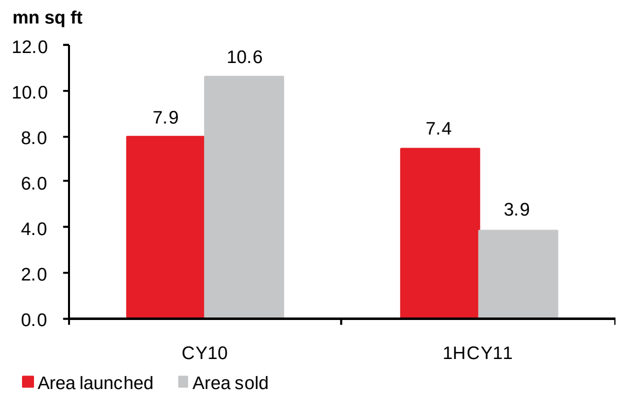

Source: Company data

### Fig. 13: Total area sold



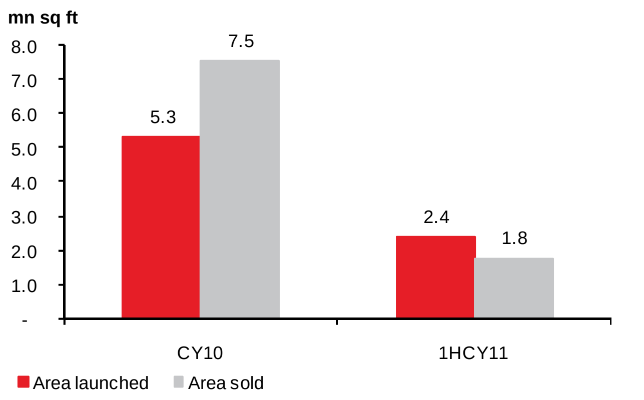

Source: Company data

### Fig. 14: Total area launched / sold



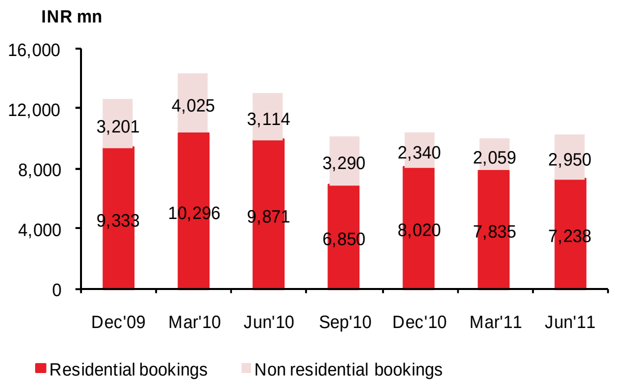

Source: Company data

### Fig. 15: Area launched / sold in NCR



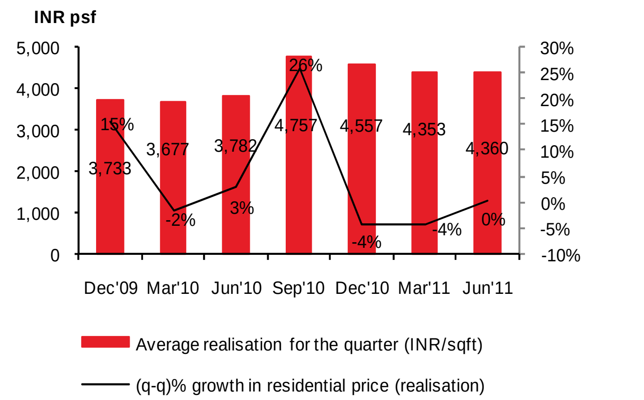

Source: Company data

### Fig. 16: Total sales booking



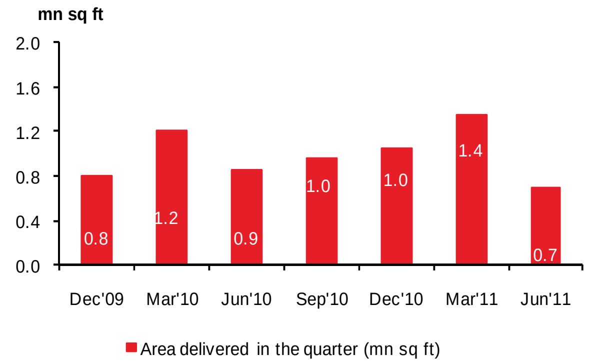

Source: Company data

### Fig. 17: Avg price realised (residential)



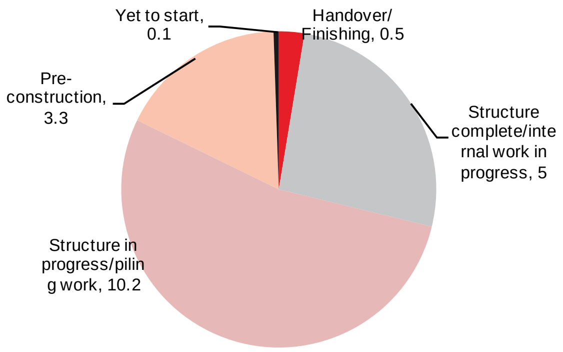

Source: Company data, Nomura research

**Fig. 18: Area delivered**




Source: Company data

**Fig. 19: Construction status of projects launched since Mar 2009**




Source: Company data

## Financials

Following the changes in our estimates, our revenue for FY12F is cut by 5% while for FY13F it is down by 13%. Our EBITDA margins for FY12F and FY13F stand reduced by 780bps and 830bps, respectively. Our EPS estimates for FY12F and FY13F consequently drop by 27% and 31%, respectively. We also introduce our FY14F estimates. The stock is now more than building in these lowered estimates, we think.

## Valuation methodology and risks

Our 12-month price target is INR42. We value the company in two parts: 1) net asset value of the current land bank at INR49 (previously INR59) per share and a discount of 20% on the same in line with the historical discount (no discount was assigned previously) and 2) Unitech Infra valued at INR3 (previously INR5) per share. Our weighted average cost of capital assumption is 15.25%.

Downside risks include: 1) any negative outcome of the investigation in the telecom scandal, 2) dumping of pledged shares in the market by lenders, 3) a reduction in liquidity and capital availability for developers, 4) stalled economic growth recovery, 5) an inability to successfully sell projects or construct them, and 6) rising interest rates.

# Scenario analysis: What if the US and Europe slip back into recession?

As the markets have been signaling that risks to our baseline forecasts are on the downside, our global economics team have considered a bear case economic scenario, most obviously triggered by a market meltdown, but the fragile state of the advanced economies leaves them vulnerable to unforeseen shocks or policy errors. For details, see Global Weekly Economic Monitor, 12 August 2011, and Global market turbulence: Implications for Asia, 9 August 2011.

The bear case scenario assumes:

- The US and Euro area slip back into recession, with US GDP averaging -1% saar in 2H11 and Euro GDP averaging -3% before recovering to around 2% growth in 2012.
- The CRB commodity price index falls 15% between now and year-end, but starts rising back again through 2012 reaching current levels by end-2012.

If there is a market meltdown and recessions in the US and euro area, we have no doubt that initially many economies in the region would be hit hard again in an echo of the global financial crisis, as non-linear effects start to kick in, notably financial decelerator effects, multiplier effects of weakening exports on domestic capex and jobs, and capital flight. However, less disturbing this time around are the two factors that there is less leverage in the financial system (less room for capital flight) and less chance of Asian trade finance drying up, as the world's central banks have most likely learnt the need to provide ample USD liquidity through FX swap arrangements.

In this scenario, we find Hong Kong, Singapore, Malaysia and Taiwan to be among the most vulnerable. But, as in 2009, we would expect that, over time, powerful tailwinds would develop, allowing Asia to bounce back before other regions. These tailwinds include a likely further decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies – more so than any other region. In our bear case scenario, we would expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia, attracted by stronger growth, superior fundamentals and higher interest rates relative to other regions.

What if things get even worse than we can foresee? Although our global economics team does not see such a situation as plausible at the moment, they have run an extreme-case scenario analysis to provide some perspective. This extreme scenario assumes:

- US GDP averaging about -4% saar in 2H11 and Euro GDP averaging -6.5% before recovering to around 1% growth in 2012.
- CRB commodity price index falls 40% between now and year-end, and stays at the lower level through 2012.

The table below summarises both the official bear case and the hypothetical extreme case scenarios.

The global bear case does not look bad for much of Asia and in fact is marginally better than the base case for China in 2012 because we would expect a V-shape rebound for the region thanks to the likely decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies. We would also expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia. In the extreme case, however, even these strengths will be tested.

**Fig. 20: Real GDP growth forecasts: baseline and downside scenarios**

| | 2011F | | | 2012F | | |
|---|---|---|---|---|---|---|
| | Base case | Bear case | Extreme case | Base case | Bear case | Extreme case |
| Australia | 2.2 | 1.5 | 0.9 | 4.6 | 3.5 | 3.3 |
| China | 9.5 | 9.0 | 8.5 | 8.6 | 8.8 | 6.0 |
| Hong Kong | 5.4 | 4.4 | 3.4 | 4.5 | 4.0 | 1.2 |
| India | 7.7 | 7.0 | 6.5 | 7.9 | 7.6 | 7.0 |
| Indonesia | 6.5 | 6.0 | 4.8 | 7.0 | 6.8 | 4.0 |
| Malaysia | 4.7 | 4.0 | 1.0 | 5.1 | 4.8 | -0.4 |
| New Zealand | 2.2 | 1.8 | 1.4 | 3.5 | 3.5 | 3.3 |
| Philippines | 5.1 | 4.7 | 3.3 | 5.7 | 5.3 | 2.4 |
| Singapore | 5.6 | 4.3 | 1.5 | 5.3 | 5.1 | -1.8 |
| South Korea | 3.5 | 2.5 | 1.5 | 5.0 | 5.0 | 2.5 |
| Taiwan | 4.5 | 3.6 | 2.4 | 5.0 | 4.9 | 0.9 |
| Thailand | 4.1 | 3.5 | 0.6 | 4.7 | 4.5 | -0.5 |
| Vietnam | 6.4 | 6.0 | 4.5 | 6.9 | 6.5 | 4.2 |
| Asia ex Japan, Aus, NZ | 7.9 | 7.2 | 6.4 | 7.6 | 7.6 | 5.1 |

Source: CEIC and Nomura Global Economics. Units: % y-y

## What does this mean for Unitech?

During the last financial crisis, the company traded at ~60% discount to its NAV. On current price, the stock is trading at ~45% discount to our revised NAV of INR49 per share plus Unitech Infra value.

Based on our assessment, we expect corrections of 15% and 25% in overall home prices in bear and extreme case scenarios. The expected impact of these changes is shown in the below exhibit.

**Fig. 21: Earnings and target price sensitivity for Unitech**

| (INR) | Base case | Bear case | Downside % | Extreme case | Downside % |
|---|---|---|---|---|---|
| 2012F EPS | 2.06 | 0.94 | -54% | 0.19 | -91% |
| 2013F EPS | 2.38 | 1.07 | -55% | 0.19 | -92% |
| 12-m target price | 42 | 24 | -43% | 12 | -71% |

Note: Base case represents our current forecasts and TP

Source: Nomura estimates

# Appendix A-1

## Analyst Certification

We, Aatash Shah and Vineet Verma, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

## Issuer Specific Regulatory Disclosures

### Mentioned companies

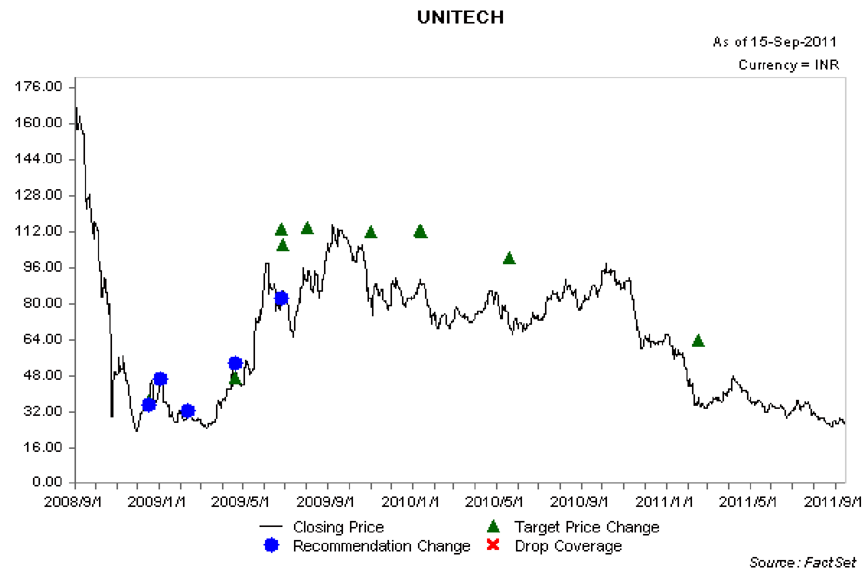
| Issuer name | Ticker | Price | Price date | Stock rating | Sector rating | Disclosures |
|---|---|---|---|---|---|---|
| Unitech | UT IN | INR 29 | 20-Sep-2011 | Buy | Not rated | |

### Previous Rating

| Issuer name | Previous Rating | Date of change |
|---|---|---|
| Unitech | Reduce | 26-Jun-2009 |

**Unitech (UT IN)** **INR 29 (20-Sep-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)




| Date | Rating | Target price | Closing price |
|---|---|---|---|
| 16-Feb-2011 | | 64.00 | 38.20 |
| 20-May-2010 | | 100.00 | 70.20 |
| 14-Jan-2010 | | 112.00 | 88.20 |
| 11-Jan-2010 | | 112.40 | 90.40 |
| 02-Nov-2009 | | 112.00 | 82.25 |
| 03-Aug-2009 | | 114.00 | 94.60 |
| 29-Jun-2009 | | 106.00 | 85.30 |
| 26-Jun-2009 | | 113.00 | 82.35 |
| 26-Jun-2009 | Buy | | 82.35 |
| 20-Apr-2009 | | 47.00 | 53.75 |
| 20-Apr-2009 | Reduce | | 53.75 |
| 11-Feb-2009 | Buy | | 32.15 |
| 02-Jan-2009 | Reduce | | 46.40 |
| 17-Dec-2008 | | 37.00 | 34.90 |
| 17-Dec-2008 | Neutral | | 34.90 |

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** Our 12-month price target is INR42. We value the company in two parts: 1) net asset value of the current land bank at INR49 per share and a discount of 20% on the same in line with the historical discount and 2) Unitech Infra valued at INR3 per share. Our weighted average cost of capital assumption is 15.25%.

**Risks that may impede the achievement of the target price** Downside risks include: 1) any negative outcome of the investigation in the telecom scandal, 2) dumping of pledged shares in the market by lenders, 3) a reduction in liquidity and capital availability for developers, 4) stalled economic growth recovery, 5) an inability to successfully sell projects or construct them and 6) rising interest rates.

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**STOCKS**

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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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%.

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