Property | India

DLF DLFU IN

BUY

NOMURA

NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

COMPANY QUICK COMMENT

Delays in approvals and shortage of labour resulted in lower-than-expected operational performance for DLF in 2QFY12, according to management. Cash inflow from the expected sale of new launches of c.7-8mn sq ft in 2HFY12 (largely plotted development), cash realization from the sale of IT parks in Pune & Noida in FY12F, and a focus on project execution / delivery should help ease concerns around company's cash flows / gearing, in our view. With the possibility of interest rates peaking soon, we believe DLF would be a prime beneficiary. Maintain BUY.

Price target: 270.0 INR   Price (11 Nov 2011): 227.5 INR

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2QFY12: Key takeaways from conf call: Operational challenges resulted in weak quarter

1. The company noted that it was a challenging quarter operationally as 1) a delay in approvals resulted in a push back of new launches; and 2) a shortage of labour led to slow construction progress at its ongoing projects.

2. To address the problem of labour shortage, DLF is now planning to appoint experienced turnkey players for project execution instead of doing it through its in-house construction company. We view this move to be positive, given this should speed up the construction pace and help in faster realization of cash; however, on the flip side, this may push up the construction cost a bit for the company.

3. The company guided that it achieved an EBITDA margin of around c.45% on FSI sales, lower than our expectation but quite similar to its current overall margin of 47%. The company believes that it will maintain its EBITDA margin in the range of 45-50% going forward.

4. The company retained that it will continue to adopt a cash conservation strategy and focus on selling plotted developments. It is planning to launch nearly 4 mn sq ft of plots in 2HFY12 across Chandigarh, Gurgaon & Lucknow.

5. The company incurred capex of around INR2.3bn for 2QFY12 and INR6.3bn for 1HFY12 towards commercial projects and land replenishment. In the next few quarters, the company intends to spend at a similar run rate of around INR2-3bn per quarter. Recently, DLF acquired some contiguous land parcels in Chandigarh and Gurgaon.

6. The company sold nearly 3.5mn sq ft in 1HFY12. Despite targeted fresh launches of around 7-8mn sq ft (which include largely plotted development) in 2HFY12F, we believe the company may miss our FY12F sales volume estimates of nearly 11 mn sq ft (including plots+ residential + commercial projects).

7. Management remained confident on asset sale progress of an IT Park in Noida and SEZ in Pune and expects realization of these sales in the current quarter (3QFY12). Assuming sale of IT Parks (totaling c. INR11.7bn) plus INR8.8bn of asset sales achieved so far in 1HFY12, the company could achieve divestment totaling c.INR20.5bn in FY12F, on our numbers vs. its target of INR30bn. However, this doesn't include sale of Aman resorts for which the company has received a total of 4 bids. So far, the company has received total cash of around INR4.1bn, on INR 8.8bn worth of assets sold in 1HFY12.

8. Addressing the market reports related to the sale of NTC Mill land in Mumbai, DLF noted that it has not formalized any plans for disposing or executing the project, citing the uncertain macro environment. In our view, given a large oversupply in the Lower Parel micro market and execution challenges related to Mumbai, where the company does not have any significant presence, the company may be looking to monetize this asset, especially considering the absolute quantum that can be realized from this sale. Notably, if it were to sell the property, management commented that DLF would receive 60% of the amount while remaining 40% would go to the promoters of DLF (on conversion of issued preference shares).

9. Due to an increase in gearing , the cost of debt moved up further by 0.75% to 12.5% (2QFY12) vs. 11.75% in 1QFY12 and 11.25% in 4QFY11. Separately, the company suffered a mark-to-market forex loss of INR1.42bn in the quarter on the outstanding foreign loan of US$240mn pertaining to its subsidiary Aman Resorts.

We look for gearing to drop in coming quarters underpinned by the sale of new launches (~7-8mn sq ft), cash inflows from asset sales, increased focus on execution / delivery and lower capital expenditure towards commercial assets. We maintain our BUY rating on the stock.

Valuation Methodology and Investment Risks: We value DLF Ltd using a net asset value (NAV) methodology, which is a DCF valuation of the development potential of the company's land reserves and developed property. We do not attach any premium or discount to this NAV to arrive at our target price. Our target price of INR270 is based on INR219 for the land bank NAV, INR29 for noncore assets and land, and INR21 for its 57% stake in DLF Cyber City Developers Ltd(DCCDL). Downside risks include 1) further rapid increases in interest rates; 2) below-expectation growth in the economy; 3) execution lagging expectations; 4) a credit crunch-like environment resulting in developers being unable to refinance their debt; 5) equity dilution to repay debt; and 6) inability to sell noncore assets.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Issuer Specific Regulatory Disclosures

Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
DLF	DLFU IN	227.5 INR	11 Nov 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
DLF	Neutral	29 Jun 2011

DLF (DLFU IN) **227.5 INR (11 Nov 2011)** Buy

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
29-Jun-2011		270.00	209.50
29-Jun-2011	Buy		209.50
14-Mar-2011		253.00	228.30
20-May-2010		296.00	271.05
29-Mar-2010		330.70	299.15
02-Feb-2010		331.00	326.20
02-Feb-2010	Neutral		326.20
02-Nov-2009		330.00	370.00
29-Jun-2009		292.00	338.00
06-May-2009		152.00	245.95
20-Apr-2009		164.00	230.80
20-Apr-2009	Reduce		230.80
11-Feb-2009		138.00	150.85
11-Feb-2009	Neutral		150.85

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

Valuation Methodology We value DLF Ltd using a net asset value (NAV) methodology, which is a DCF valuation of the development potential of the company's land reserves and developed property. We do not offer any premium or discount to this NAV to arrive at our target price. Our target price of INR270 per share is based on INR219 for the land bank NAV, INR29 for non-core assets and land and INR21 for its 57% stake in DLF Cyber CIty Developers Ltd(DCCDL).

Risks that may impede the achievement of the target price Downside risks include: 1) further rapid increases in interest rates; 2) below-expectation growth in the economy; 3) execution lagging expectations; 4) a credit-crunch like environment resulting in developers being unable to refinance their debt; 5) equity dilution to repay debt and 6) inability to sell non-core assets.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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