24 September 2012

Update | Sector: Real Estate

DLF

BSE SENSEX	S&P CNX
18,753	5,691

Bloomberg	DLFU IN
Equity Shares (m)	1,714.4
52-Week Range (INR)	261/170
1,6,12 Rel. Perf. (%)	4/12/1
M.Cap. (INR b)	402.9
M.Cap. (USD b)	7.5

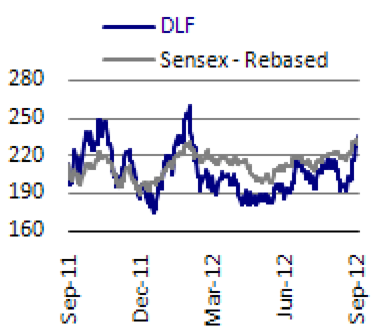
Valuation summary (INR b)

Y/E March	2012	2013E	2014E
Net Sales	96.3	85.5	107.9
EBITDA	39.0	35.9	45.1
NP	12.0	15.2	16.5
BV/Sh. (INR)	150.9	157.5	164.1
EPS (INR)	7.1	9.0	9.7
EPS Gr. (%)	-26.8	26.5	19.5
P/E (x)	33.2	26.3	21.9
P/BV (x)	1.6	1.5	1.4
EV/EBITDA (x)	16.0	16.8	12.2
EV/ Sales (x)	6.5	7.1	5.1
RoE (%)	4.5	5.5	5.7
RoCE (%)	7.4	8.4	8.3

Shareholding pattern %

As on	Jun-12	Mar-12	Jun-11
Promoter	78.6	78.6	78.6
Dom.Inst.	0.3	0.3	0.4
Foreign	15.8	15.6	15.1
Others	5.3	5.5	5.9

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

CMP: INR235 | TP: INR286 | Buy

Poised for re-rating on favorable macro impetus

Operating consolidation, large ticket divestments to pay off

- **DLF is a major beneficiary of recent policy reforms and favorable macro trends.**
- **Expect meaningful improvement in operating cash deficit (break-even by FY14) on the back of (1) re-aligning core operations to premium business mix, (2) focus on margin protection, and (3) execution ramp-up.**
- **Success in large divestments implies higher potential to de-leverage, making DLF a strong play on rate downcycle. Expect net DER at 0.8x/0.69x in FY13/14.**
- **The stock trades at 1.4x FY14E BV and 18% discount to NAV. Buy with TP of INR286.**

Major beneficiary of favorable macro impetus

Recent favorable macro trends – much-awaited FDI in multibrand retail coupled with expected interest rate downcycle – portend well for the real estate (RE) sector. We believe DLF is a major beneficiary in the sector of these positive developments. We expect the ongoing upswing to get further boosted by the dual effect of improving operating leverage and financial de-leveraging.

Operating consolidation should pay off

Amidst challenging macro, DLF embarked on a four-pronged operating consolidation strategy: (1) Core markets and assets, (2) Premium margins, (3) Execution outsourcing, and (4) Value creation through infrastructure development. Its favorable near-term market and product mix offer higher conviction on a meaningful uptick in FY13 sales (we estimate ~INR60b v/s INR53b in FY12). A key trigger would be launch of Magnolia II in 3QFY13, with expected FY13 sales value of ~INR15b). Expect margins and cash flow to be resilient on the back of super premium launches coupled with inflation-combating strategies. We estimate DLF's operating cash deficit (post interest outgo) to improve significantly in FY13 to INR8.1b (v/s INR20.4b in FY12) before breakeven in FY14.

Large ticket divestments to drive de-leveraging

Recent success in NTC Mill divestment (INR27b to Lodha group) along with encouraging payment structure re-affirms DLF's priority on immediate cash flow. Management has guided for Aman Resort transaction (by 3QFY13 at indicative value of INR17-18b) followed by windmills (~INR9b), and near-term de-leveraging of INR40-50b (target net DER 0.6x by FY14-end). Thus, we believe DLF is also a strong play on interest rate downcycle. We model in INR20-22b annual debt reduction over FY13/14, resulting into net DER of 0.8x/0.69x.

Upgrade of 6-8% in EPS and 10% in target price; Buy

We upgrade FY13/14 EPS by 6-8%, led by 3-4% upward revision in sales estimates and higher divestment. The stock trades at a P/E of 22x FY14E EPS and 1.4x FY14E BV and 18% discount to NAV. **Buy** with upgraded TP of INR286. We expect the 2HFY13 triggers to be (a) Divestment of Aman resort (INR17-18b) and windmills (INR9b), (b) Higher than expected (INR20b) debt reduction, and (c) successful launch of Magnolia II.

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Major beneficiary of favorable macro impetus

Beneficiary of 51% FDI in multibrand retail, expected rate downcycle

Policy reforms positive for sector in general, DLF in specific

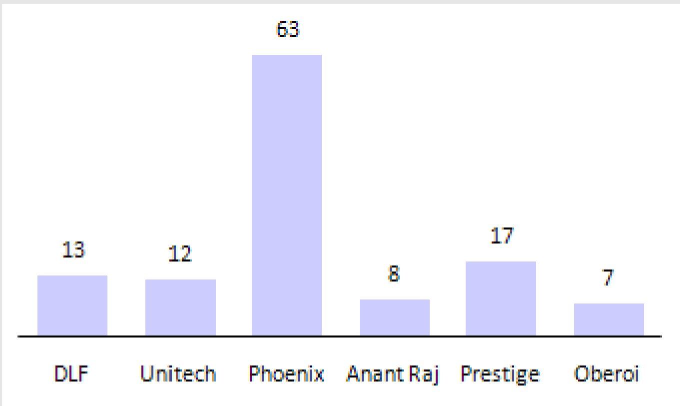
Recent announcement of 51% FDI in multi-brand retail and relaxation of norms in single brand FDI will have a positive impact on RE demand for retailing. While actual demand creation may take 1-2 years, the development is a strong sentimental positive for developers like DLF with exposure to retail vertical. It has 1.4msf of operational retail area (INR2.5b of annualized rental), along with ~1.8msf under construction (Mall of India, Noida) expected to be operational by 1HFY14.

DLF has almost 20-22msf poised for retail development, including 3msf+ Mall of India, Gurgaon (we estimate retail vertical to account for 13% of DLF's NAV). However, given muted outlook during the past 2 years, it had restricted its retail capex and focused only on operating efficiency of existing malls. Nonetheless, going forward, we expect a significant revival in its retail expansion plan over medium term, which has strong potential to augment its annuity income (estimated at ~INR20b in FY13), along with uptick in rental values existing assets. This is on the back of favourable macro outlook, much controlled oversupply situation, and lower vacancy at existing DLF malls (7% in FY12, down from 11% in FY11).

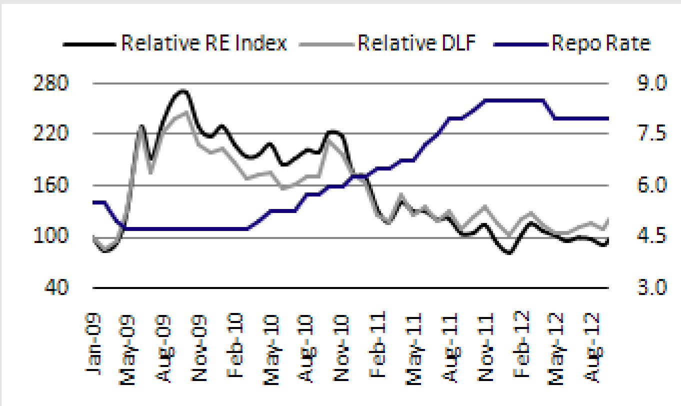
Interest rate downcycle an additional positive

Favourable global liquidity, rising expectations of fiscal correction, recent 25bp CRR cut, and likely interest rate downcycle are all major positives for the operating and financial health of levered developers. While DLF's stock price has always been strongly correlated with interest rate cycle, this time, the same could be amplified due to certainty over DLF's own divestment-led deleveraging e.g. a 100bp rate cut can save DLF INR2.5b on interest outgo.

Retail vertical accounts for almost 13% of DLF NAV



Stock Price depicted strong correlation with rate cycle



Source: Company, MOSL

Operating consolidation should pay off

Right product and market mix to help operating cash breakeven by FY14

4-pronged strategy to align operations with core strengths

Amidst challenging macro, DLF embarked on a four-pronged strategy to align its operations with its core strengths:

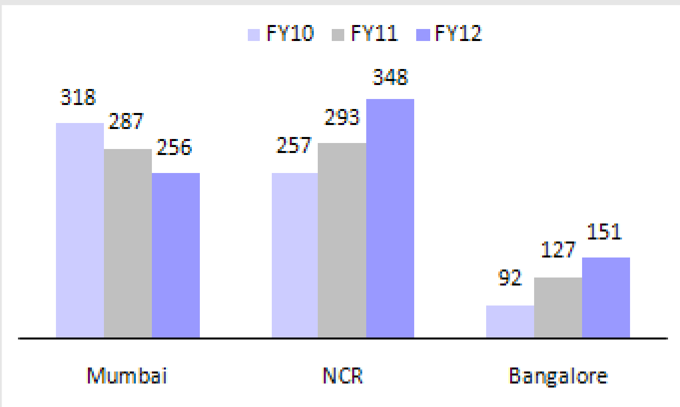
1. **Consolidating land parcels at core NCR markets** and aligning near-term launches in outperforming NCR (New Gurgaon, Chandigarh) and Southern cities (Bengaluru, Chennai)
2. **Focus on premium and plotted segments** to mitigate inflation and maintain profitability
3. **Execution outsourcing to third party contractors** to ramp up delivery and improve cash cycle
4. **Value creation through infrastructure development** around existing land parcels e.g. (1) 16-lane signal-free road to reach the Golf Course Road from the Gurgaon toll plaza within 7 minutes (INR6b JV with HUDA, Haryana Urban Development Authority), and (2) Metro rail connectivity for Cyber City (26:74 JV with IL&FS) and residential projects.

Business mix focus caters to outperforming markets, premium segments

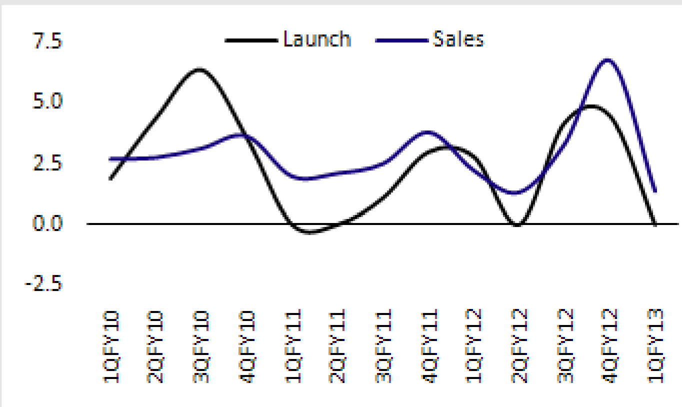
DLF has adopted a back-to-core strategy in choosing its near-term market mix, with proposed launches skewed in favor of outperforming markets like NCR (Gurgaon, Chandigarh) and Southern cities (Bangalore, Chennai). Its recent NCR launches have seen impressive sales momentum along with 20-40% premium in realizations (e.g. Primas in Sector 82A and Regal in Sector 90 were sold at 40% premium to New Gurgaon's prevailing prices).

Market-mix apart, DLF is also focusing on its product-mix. FY13 sales will be an even mix of plotted and luxury projects, along with super-luxury Magnolia II (1msf @INR18,000+/sf) getting launched in 3QFY13. DLF strong ability to leverage its brand equity in NCR market offers high comfort on success of its planned launches. We estimate FY13 sales of ~INR60b v/s guidance of ~INR65b and INR53b in FY12.

DLF's near-term market mix skewed towards better-performing NCR and southern markets (Sales value, INR b)

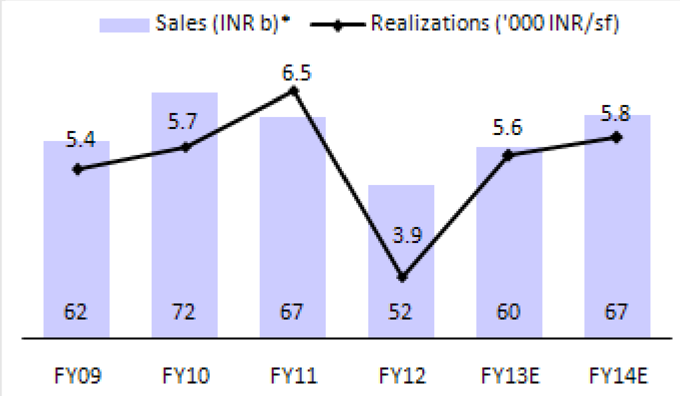


DLF's strong brand offers a huge correlation between project launch and offtake (msf), especially in NCR market

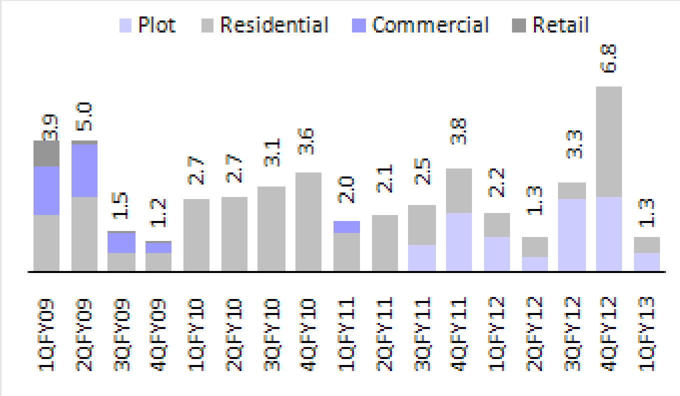


Source: Liases Foras, Company, MOSL

Expect FY13/14 sales at INR60/67b, realizations to improve with premium launches



Sales mix trend (msf): FY13 mix to have higher proportion premium sales, improving realizations



Source: Company, MOSL

Execution outsourcing likely to bolster cash conversion

DLF is increasingly outsourcing construction to reputed third party partners such L&T and Shapoorji Pallonji Group. This is expected to (1) improve project certainty and turnaround time, (2) enhance brand value of its projects, and (3) aid faster cash conversion cycle. The company is guiding for 10-11msf of annual delivery over FY13 and FY14.

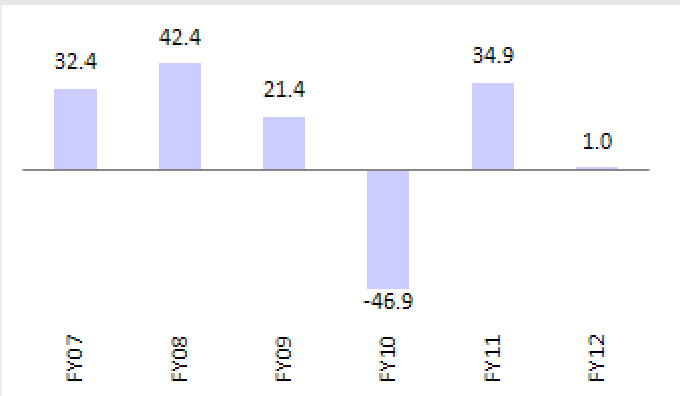
Focus on margin protection – material inclusive contract, escalation clause

Apart from higher mix of luxury projects, DLF is planning to move to "material inclusive" contracts with its construction outsourcing partners (L&T, SP Group) for all new projects to mitigate price risks in commodities like steel and cement. It is also inducing new cost escalation clause in its agreement with buyers, providing for passing on of costs (based on commodity index) during the project lifecycle. Both the above measures should offer meaningful resilience to margins.

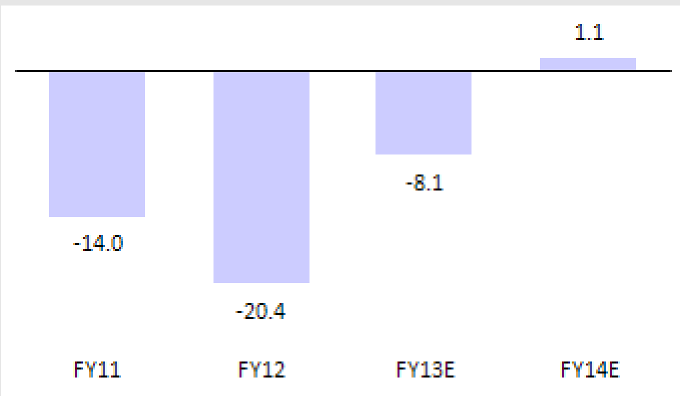
Expect operating cash breakeven by FY14

We expect DLF's operating deficit (post interest outgo) to improve significantly in FY13 to INR8.1b (v/s INR20.4b in FY12), before breaking even in FY14. This should be led by (1) better collections, (2) restrained capex in underperforming vertical (Rent Co), and (3) subsiding spend on land consolidation (major aggregation in New Gurgaon and Chandigarh is almost over). Change in (debtors + unbilled receivable) as a % of revenue bookings declined to +1% in FY12 (v/s +35% in FY11), implying improvement in customer collections.

Change in debtors as % of revenue improved



Expect operating surplus (cash from core operations minus interest outgo) to break-even by FY14 (INR b)



Weakness in commercial leasing a concern

Subdued commercial leasing and cancellations remain a key operating concern. This is attributable to (1) weaker macro (majority are overseas clients), (2) deliberate leasing slowdown to achieve higher rentals, and (3) Shilokhera litigations leading to cancellations. Going forward, we believe DLF's infrastructure initiatives (Metro connectivity to Cyber City, 16-lane road to Phase V) will augment value proposition for lessees; thus, Cyber City rental of INR65-70/sf/m should see growth of at least INR10/sf/m. We expect 15% growth in FY13 rental income from office and retail assets to INR18b (v/s INR15.5b in FY12), equally attributed by new leasing and rental growth.

Large ticket divestments to drive de-leveraging

Aggressive INR40-50b guidance for FY13; we model in INR40-45b over FY13/14

Recent divestment success reaffirms ability to conclude large deals

Recent sale of NTC Mill land at INR27b to Lodha group reaffirms DLF's ability and commitment to conclude large-ticket divestment deals. While the divestment value has been moderately below expectations (INR30-33b), the encouraging payment structure speaks for its priority on immediate cash flow. DLF has already received INR5b and the balance INR22b is to come by October 2012; the transaction does not have any debt offsetting structure).

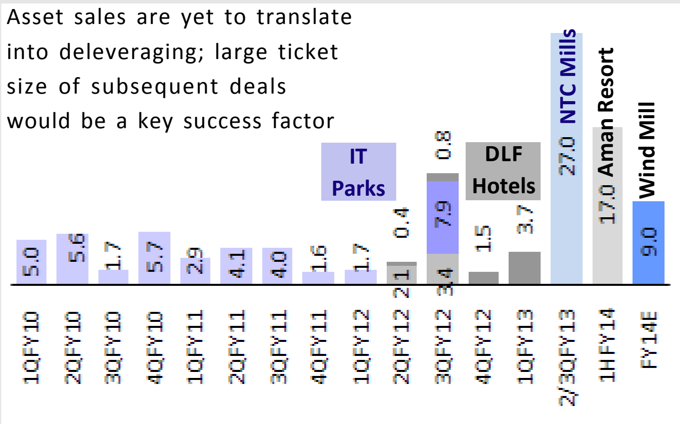
Strong guidance on remaining asset sales

The management is confident of concluding Aman Resort transaction by 3QFY13 (indicative value INR17-18b ex Lodhi), followed by windmill (~INR9b), where the company has shortlisted a few bidders. Its deleveraging guidance of INR40-50b in FY13 seems to be somewhat ambitious; we model in a conservative INR20-22b of annual debt reduction over FY13/14. We expect FY13/14 net debt at INR214b/INR192b and net DER of 0.8x/0.69x.

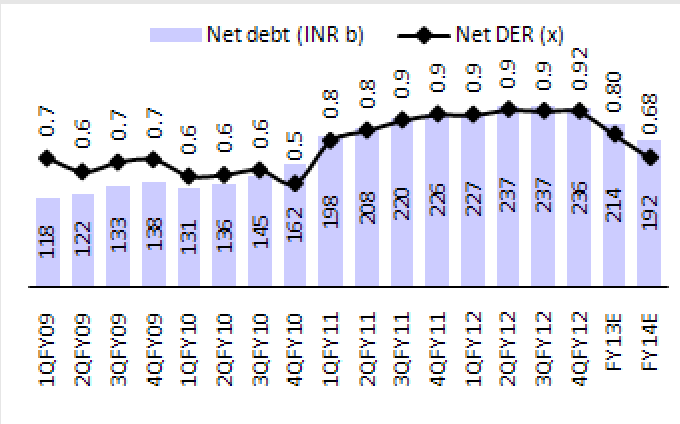
There is upside risk to our divestment estimates

Our deleveraging estimate is largely based on divestment cash proceeds of (1) ~INR33b in FY13 (INR27b from NTC Mills, INR2-3b from DLF Hotels), and (2) ~INR25b in FY14 (Aman Resort and windmills). A quicker conclusion of Aman and Windmill deals coupled with favourable payment structure would be a positive surprise.

Trend in divestments (INR b)



Estimate INR20-22b annual reduction in net debt over FY13/14



Source: Company, MOSL

Uptick in operational cash increases certainty over de-leveraging

DLF's divestment-led debt reduction has been disappointing to date (INR48b divestment (ex NTC) since FY12 but no debt reduction), due to high operating cash deficit. Going forward, steady improvement in operating cash flow is expected to increase certainty of divestment proceeds getting utilized towards debt reduction.

Key large ticket assets on near-term divestment radar

Assets	Asset details	Expected Period	Transaction value (INR b)	Buyers/Bidders	Remarks
DLF Hotel & Hospitality	17 acre land parcels at Kolkata, Chennai, Mysore and Thiruvananthapuram	1QFY13	5.7	**Sold to** Avani Projects and Square Four Housing & Infrastructure	FY11 BV of INR5.7b, thus the indiacted deal value is 1x BV
NTC Mills, Mumbai	Located in one of the most prime locations in Mumbai. DLF acquired the 17.5 acre land in 2005 at ~INR7.1b; can generate ~4.5msf of saleable area	2QFY13	27	**Sold to** Lodha Group	Over 15% discount to last NTC mills deal; all approvals in place makes it attractive for buyers; faster payment positive for DLF
Aman Resort (ex Delhi hotel)	24-25 luxury hotels	3QFY13	17-18 (Indicative Value)	Indicative price based on media report on MoU with international consortium	Purchased at USD400m in 2007; Current assets worth INR17.4b (~INR5b for Lodhi properties)
Wind Power	Installed capacity 228.7 MW and wind farms in Gujarat, Rajasthan, Tamil Nadu and Karnataka. EBITDA of ~INR1b/1.5b in FY11/12	2HFY13	~9 (Indicative Value)	Green Infra Ltd, ReNew Power Ventures Pvt. Ltd, Caparo Group and Orient Green Power Co. Ltd, (Live Mint)	Guided valuation suggests 7-8x EBITDA multiple
Near-term visibility			**50-55**		

Shaded assets have reached conclusive stage

Source: Media news, Company, MOSL

Expect operating surplus to break-even in FY14

Expect improvement in operating deficit to steer divestment-led deleveraging

Particulars (INR b)	FY11	FY12	FY13E	FY14E
Dev Co Collections	53.1	49.6	59.7	65.3
Rent Co annuity income	15.5	18.0	20.4	22.8
Construction spend	16.4	13.0	15.2	16.8
Employee + Overheads	15.1	17.6	18.3	19.0
Operating cost	3.2	3.2	4.1	4.3
Tax payment	7.5	11.5	10.0	10.0
Less: Other business loss	3.0	2.3	2.3	2.3
Add. Other income	6.0	4.1	4.1	4.1
Operating surplus pre capex, land	**29.4**	**24.2**	**34.3**	**39.8**
Less: Lease capex	6.5	4.5	3.7	5.9
Less: Land acquisitions	11.0	10.0	7.8	6.0
Operating surplus post capex, land	**11.9**	**8.5**	**22.9**	**27.9**
Less: Interest outgo	25.9	30.1	31.0	26.8
Dividend	9.1	5.9	5.9	5.9
Operating surplus post interest	**-14.0**	**-20.4**	**-8.1**	**1.1**
Add: Asset sales	12.7	17.7	33.0	25.0
Net surplus/ change in net debt	**-63.9**	**-10.0**	**18.9**	**20.1**

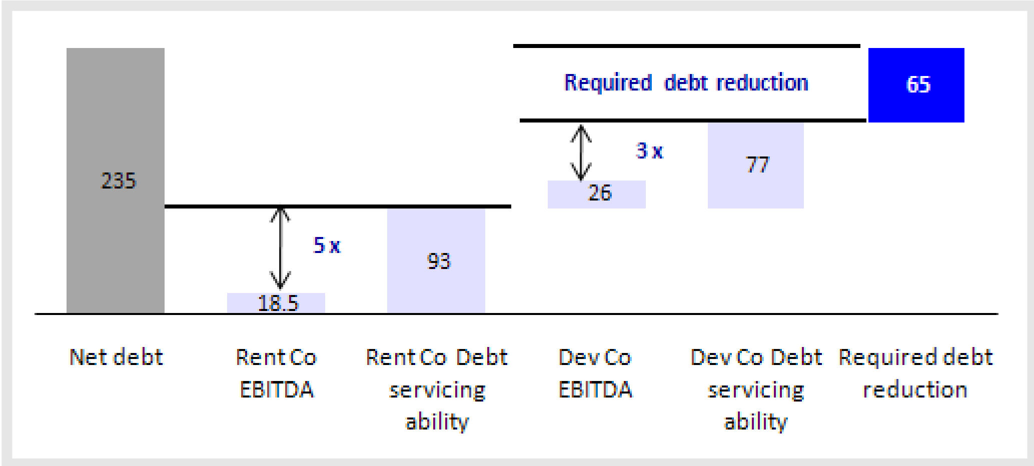
Source: Company, MOSL

We see DLF's comfort-level leverage at INR160-170b

DLF's high debt has been a key concern for investors; however, we believe leverage of INR160-170b would be a sustainable level for the company. We understand that ~INR93b of debt can be serviced by RentCo (5x its annuity EBITDA of INR18.5b). The lease-rental backed loan could also help in reducing cost of borrowing. Additionally, DevCo can support almost 3x its business EBITDA (DevCo EBITDA is estimated at ~INR26b) amounting to ~INR77b. Thus, de-leveraging of INR65-70b from current level of INR235b should place DLF in a comfortable leverage position.

De-leveraging of INR65-70b (from current INR235b) should make DLF comfortable

DLF's debt break-up: Need INR65-70b reduction (INR b)



Source: Company, MOSL

Upgrade of 6-8% in EPS and 10% in target price; Buy

Legal overhangs worst-case risk of INR13/share

Buy with target price of INR286

We upgrade our FY13/14 EPS by 6-8% on the back of 3-4% upward revision in sales estimates and higher divestment proceeds. The stock trades at a P/E of 22x FY14E EPS and 1.4x FY14E BV and 18% discount to NAV. **Buy** with upgraded target price of INR286 (removing 10% discount to NAV due to favorable macro). We expect the 2HFY13 triggers to be (a) Divestment of Aman resort (INR17-18b) and Wind Mills (INR9b), (b) Higher than expected (INR20b) debt reduction, and (c) successful launch of Magnolia II.

Legal overhangs – worst-case risk of INR13/share

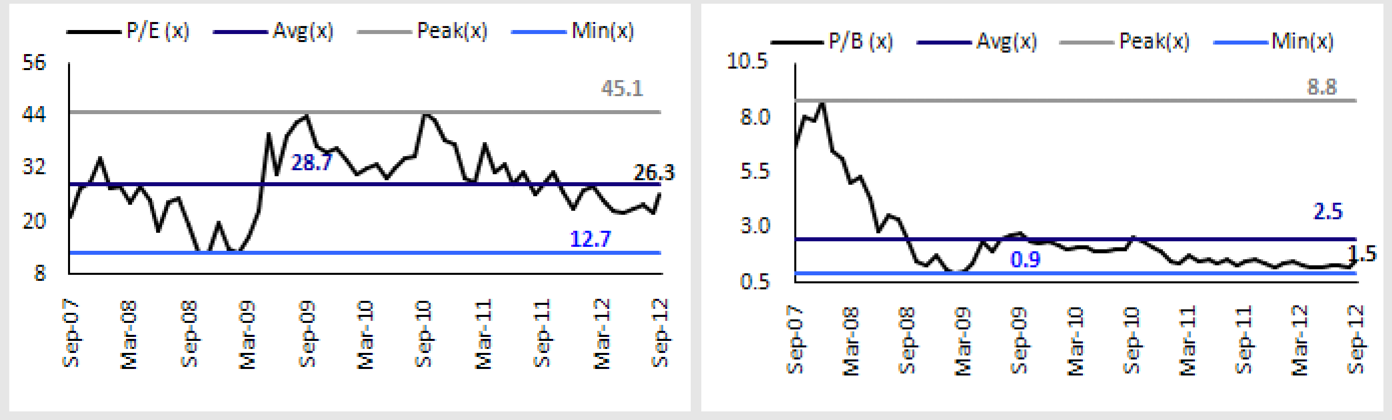
DLF stock price has been severely impacted by various legal conflicts, viz, CCI penalty (INR6.3b), income-tax claims (~INR35b owing to DAL SEZ assets), litigation at Silokhera SEZ, etc. We believe, in line with management's expectations, that most of the proceedings would be long-drawn, and unlikely to reach any conclusions over the near term. However, of the INR35b tax claim, DLF has already paid INR15b, and also got relief in one case of INR4b. Assuming an adverse outcome on CCI and tax issues, we estimate the worst-case impact to be INR13/share (assumed in NAV).

Estimate NAV at INR286

	GAV	NAV/Share	% of NAV	% of GAV
Residential	**580,815**	**339**	**118.6**	**53.8**
Commercial	**310,700**	**181**	**63.4**	**28.8**
Commercial complex	104,367	61	21.3	9.7
Lease inlcuding DAL	206,333	120	42.1	19.1
Retail	**146,672**	**86**	**29.9**	**13.6**
Institutional Plots	**12,685**	**7**	**2.6**	**1.2**
Aman/Hotel Plots and wind Power	**29,250**	**17**	**6.0**	**2.7**
GAV	**1,080,123**	**630**	**220.5**	**100.0**
Tax	243,515	142	49.7	22.5
Net debt	220,212	128	44.9	20.4
Land cost due	14,000	8	2.9	1.3
Operating expense	90,177	53	18.4	8.3
Contingencies	22,300	13	4.6	2.1
NAV	**489,919**	**286**	**100.0**	**45.4**

Source: MOSL

Current valuations at discounts to historical long-period average



Financials and Valuation

Income Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Net Sales	**74,209**	**95,606**	**96,294**	**85,482**	**103,723**
Change (%)	-26.1	28.8	0.7	-11.2	21.3
EBITDA	**35,012**	**37,527**	**39,043**	**35,889**	**44,053**
% of Net Sales	47.2	39.3	40.5	42.0	42.5
Depreciation	3,246	6,307	6,888	7,295	7,662
Interest	11,075	17,056	22,465	23,585	19,736
Other Income	4,333	5,839	5,945	14,996	7,367
PBT	**25,024**	**20,002**	**15,635**	**20,005**	**24,023**
Tax	6,957	4,594	3,694	5,201	6,246
Rate (%)	27.8	23.0	23.6	26.0	26.0
Reported PAT	**17,300**	**16,396**	**12,008**	**15,191**	**18,243**
Extra-ordinary Income	870	-72	0	0	0
Adjusted PAT	**17,300**	**16,396**	**12,008**	**15,191**	**18,243**
Change (%)	-61.3	-5.2	-26.8	26.5	20.1

Balance Sheet (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Equity Capital	3,394	3,394	3,394	3,394	3,394
Preference Capital	13,960	13,960	13,850	13,850	13,850
Reserves	286,973	245,967	255,114	266,334	280,605
Pref Shares/ CCP's	59,199	18,104	17,994	17,994	17,994
Net Worth	**304,327**	**263,321**	**272,359**	**283,578**	**297,850**
Loans	216,766	239,906	250,660	225,815	203,233
Deffered Tax Liability	2,515	0	0	0	0
Minority Interest	6,278	5,752	4,207	4,207	4,207
Capital Employed	**529,886**	**508,979**	**527,225**	**513,599**	**505,290**
Goodwill	12,680	13,840	16,248	16,248	16,248
Gross Fixed Assets	178,845	198,277	212,949	216,161	221,642
Less: Depreciation	13,265	19,556	25,809	33,104	40,765
Net Fixed Assets	**165,580**	**178,721**	**187,140**	**183,057**	**180,876**
Capital WIP	111,288	102,344	89,928	90,381	90,814
Investments	55,052	9,958	11,268	9,014	9,014
Curr. Assets	**397,864**	**452,069**	**487,718**	**499,227**	**510,101**
Inventory	124,806	150,388	161,756	168,792	173,808
Debtors	16,190	17,536	19,100	20,505	21,306
Cash & Bank Balance	9,282	13,218	15,063	13,636	13,317
Inventory	124,806	150,388	161,756	168,792	173,808
Loans and Advances	75,933	41,664	51,741	54,680	55,040
Other Current Assets	46,847	78,875	78,302	72,821	72,821
Current Liab. & Prov.	**87,771**	**99,199**	**106,671**	**118,884**	**131,304**
Creditors	46,370	92,249	98,639	110,852	123,273
Provisions	41,402	6,950	8,032	8,032	8,032
Net Current Assets	**185,286**	**202,482**	**219,291**	**211,550**	**204,988**
Application of Funds	**529,886**	**508,979**	**527,225**	**513,599**	**505,290**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2010	2011	2012	2013E	2014E
Basic (INR)					
Adjusted EPS	**10.2**	**9.7**	**7.1**	**9.0**	**10.7**
Growth (%)	-61.3	-5.2	-26.8	26.5	20.1
Cash EPS	12.6	12.8	11.0	13.0	15.0
Book Value	171.8	147.0	150.9	157.5	165.9
DPS	1.1	0.9	2.0	2.0	2.0
Payout (incl. Div. Tax.)	11.9	11.0	33.1	26.1	21.8
Valuation (x)					
P/E			33.2	26.3	21.9
Cash P/E			21.4	18.0	15.7
EV/EBITDA			16.0	16.8	13.2
EV/Sales			6.5	7.1	5.6
Price/Book Value			1.6	1.5	1.4
Dividend Yield (%)			0.9	0.9	0.9
Profitability Ratios (%)					
RoE	6.3	5.8	4.5	5.5	6.3
RoCE	7.7	7.1	7.4	8.4	8.6
Leverage Ratio					
Debt/Equity (x)	0.7	0.9	0.9	0.8	0.7

Cash Flow Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
PBT before EO Items	**25,024**	**20,002**	**15,475**	**20,005**	**24,023**
Add : Depreciation	3,246	6,307	6,888	7,295	7,662
Interest	11,075	17,056	22,465	23,585	19,736
Less : Direct Taxes Paid	6,957	4,594	3,694	5,201	6,246
Inc/Dec in WC	-50,020	13,260	14,964	-6,314	-6,243
CF from Operations	**82,391**	**25,511**	**26,170**	**51,895**	**51,305**
CF from Investments	**-175,102**	**31,286**	**-6,842**	**-1,411**	**-5,914**
(Inc)/Dec in Networth	50,477	-58,114	1,000	0	0
(Inc)/Dec in Debt	53,565	23,139	10,754	-24,845	-22,581
Less : Interest Paid	11,075	17,056	22,465	23,585	19,736
Dividend Paid	2,060	1,803	3,971	3,971	3,971
CF from Fin. Activity	**90,908**	**-53,833**	**-14,682**	**-52,402**	**-46,289**
Inc/Dec of Cash	**-2,674**	**3,936**	**1,845**	**-1,427**	**-319**
Add: Beginning Balance	11,956	9,282	13,218	15,063	13,636
Closing Balance	**9,282**	**13,218**	**15,063**	**13,636**	**13,317**

E: MOSL Estimates

N O T E S

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