Equities

14 November 2011 | 12 pages

DLF (DLF.BO)

Q2FY12: A Slow Quarter Operationally

- Company Update
- Target Price Change
- Estimate Change

- **Revenue/PAT up 4% QoQ** — Revenue came in at ~Rs 25.3b, up 7% YoY/4% QoQ- large portion of ~Rs 6 b of FSI sales was recognized. Margins at 46% improved 100bps QoQ- management expects steady ~45% margins going forward. PAT at ~Rs3.7b declined 11% YoY (higher interest cost & taxes/lower other income), up 4% QoQ. Headlines numbers were ahead of expectations led by higher Topline/better margins.
- **Slow sales & launches in Q2, as expected** — Sale of 1.3msf in Q2 (~0.6msf in plotted, remaining in mid-income homes) vs 2.2msf in Q1. Launches largely absent in Q2 due to delayed approvals– ~0.5msf added to execution schedule. Company has a 6.5-7.5msf launch pipeline in 2H - approvals in place for ~3.0msf expected in CY11.
- **Net D/E remains high at 0.81x…** — This is versus 0.79x in Q1 and was led by net debt increase of Rs 10b- Rs 1.4b was due to non-cash forex impact on Aman Resorts' offshore loans and remaining led by bunching up of some payments and divestment cash flow delays. Company is targeting debt reduction of ~Rs 30b by FY12 end.
- **…Clarity emerging on asset sales** — While land FSI sale of ~3.0msf has already come through and collection is under way, other transactions expected to close in Q3- (1) Noida IT park sale definitive agreement signed, (2) Pune SEZ sale documentation in process with approvals in place, (3) Aman resorts received 4 bids, evaluation is on.
- **Other updates** — (1) Net leasing was weak at 0.2msf led by a cancellation of 0.4msf in Chennai property. In 1H, 0.9msf of net leasing (gross-1.6msf) has been concluded- FY12 guidance remains unchanged. (2) Delivered 2.2msf in 1H; company is looking to hand over >12msf in FY12. (3) Cost of debt is ~12.3% (vs. 11.8% in end of Q1).
- **Tweak Estimates, New TP of Rs 271** — Based on 1H performance and management commentary, we have modified our assumptions relating to cost of capital, reduced land bank and increased net debt. 2H is typically more robust and should see volumes improving, along with visible initiatives on deleveraging. DLF remains relatively better positioned within large-cap/liquid property stocks.

Buy	**1**
Price (11 Nov 11)	Rs228.35
Target price	Rs271.00
from Rs280.00	
Expected share price return	18.7%
Expected dividend yield	0.9%
Expected total return	**19.6%**
Market Cap	Rs387,768M
	US$7,758M

Price Performance
(RIC: DLF.BO, BB: DLFU IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	17,198	10.13	-61.5	22.5	1.6	7.3	0.9
2011A	16,396	9.66	-4.7	23.6	1.6	6.7	0.9
2012E	17,072	10.06	4.1	22.7	1.5	6.8	0.9
2013E	22,674	13.36	32.8	17.1	1.4	8.7	0.9
2014E	27,057	15.94	19.3	14.3	1.3	9.7	0.9

Source: Powered by dataCentral

Surendra Goyal, CFA
+91-22-6631-9870
surendra.goyal@citi.com

Vidhi Sodhani
+91-22-6631-9854
vidhi.sodhani@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	22.5	23.6	22.7	17.1	14.3
P/E reported (x)	22.5	23.6	22.7	17.1	14.3
P/BV (x)	1.6	1.6	1.5	1.4	1.3
Dividend yield (%)	0.9	0.9	0.9	0.9	0.9
Per Share Data (Rs)					
EPS adjusted	10.13	9.66	10.06	13.36	15.94
EPS reported	10.13	9.66	10.06	13.36	15.94
BVPS	144.41	144.45	149.73	158.31	169.48
NAVps ordinary	na	na	na	na	na
DPS	2.00	2.00	2.00	2.00	2.00
Profit & Loss (RsM)					
Net operating income (NOI)	**39,819**	**43,248**	**52,871**	**60,699**	**67,516**
G&A expenses	-4,703	-5,721	-6,580	-7,566	-8,701
Other Operating items	-3,241	-6,219	-6,323	-6,540	-6,851
EBIT including associates	**31,875**	**31,308**	**39,968**	**46,593**	**51,964**
Non-oper./net int./except.	-6,820	-11,217	-16,778	-15,913	-15,417
Pre-tax profit	**25,054**	**20,090**	**23,190**	**30,680**	**36,547**
Tax	-7,022	-4,594	-5,777	-7,649	-9,115
Extraord./Min. Int./Pref. Div.	-834	900	-340	-357	-375
Reported net income	**17,198**	**16,396**	**17,072**	**22,674**	**27,057**
Adjusted earnings	17,198	16,396	17,072	22,674	27,057
Adjusted EBIT	31,866	31,219	39,888	46,509	51,876
Adjusted EBITDA	35,116	37,527	46,291	53,133	58,814
Growth Rates (%)					
NOI	-34.3	8.6	22.3	14.8	11.2
EBIT adjusted	-40.6	-2.0	27.8	16.6	11.5
EPS adjusted	-61.5	-4.7	4.1	32.8	19.3
Cash Flow (RsM)					
Operating cash flow	**86,847**	**31,506**	**16,185**	**27,956**	**30,109**
Depreciation/amortization	3,249	6,307	6,403	6,624	6,939
Net working capital	57,432	-4,772	-6,517	-1,699	-4,262
Investing cash flow	**-163,024**	**40,570**	**-6,993**	**-12,000**	**-15,000**
Capital expenditure	-131,971	-4,205	-1,880	-12,000	-15,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**74,175**	**-64,034**	**-18,432**	**-12,107**	**-12,107**
Borrowings	53,811	23,157	-10,324	-4,000	-4,000
Dividends paid	-3,395	-3,395	-3,395	-3,395	-3,395
Change in cash	**-2,003**	**8,041**	**-9,239**	**3,848**	**3,001**
Balance Sheet (RsM)					
Total assets	**617,658**	**639,990**	**645,336**	**664,905**	**685,670**
Cash & cash equivalent	9,282	13,461	4,456	7,948	10,574
Net fixed assets	276,868	281,841	277,318	282,694	290,755
Total liabilities	**307,053**	**370,917**	**366,723**	**371,726**	**373,541**
Total Debt	216,766	239,903	229,578	225,578	221,578
Shareholders' funds	**310,605**	**269,073**	**278,613**	**293,180**	**312,129**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	42.9	32.7	38.8	40.0	40.2
ROE adjusted (%)	7.3	6.7	6.8	8.7	9.7
ROA adjusted (%)	3.1	2.6	2.7	3.5	4.0
Net debt to equity (%)	66.8	84.2	80.8	74.2	67.6
Interest coverage (x)	3.2	2.2	2.3	2.7	3.0

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Powered by: dataCentral

Financial Performance: Beat Expectations

Revenue comprises portion of ~Rs 6.0b FSI sale carried out in Q2

Management expects margins to remain steady at ~45% levels going forward

Figure 1. Q2 & 1H-FY12 Results Snapshot (in Rs Millions)

	2QFY11	1QFY12	2QFY12	YoY	QoQ	1HFY12	YoY
Net Sales	**23,690**	**24,458**	**25,324**	**7%**	**4%**	**49,782**	**13%**
Total Expenditure	14,401	13,349	13,594			26,943	
Operating Profit	**9,289**	**11,110**	**11,730**	**26%**	**6%**	**22,840**	**20%**
OPMs	*39%*	*45%*	*46%*			*46%*	
Interest	4,338	4,964	5,263	21%	6%	10,227	24%
Other Income	1508.5	574	448	-70%	-22%	1,022	-64%
Depreciation	1,540	1,702	1,753	14%	3%	3,455	14%
PBT	**4,920**	**5,018**	**5,161**	**5%**	**3%**	**10,179**	**-4%**
PBT margins	*21%*	*21%*	*20%*			*20%*	
Total Tax	734	1,278	1,475	101%	15%	2,753	14%
Effective tax rate (%)	15%	25%	29%			27%	
PAT	**4,186**	**3,739**	**3,686**	**-12%**	**-1%**	**7,426**	**-10%**
Less: Minority Interest	-69.2	-165.6	0.4			-165	
Add: Share of Associates	-0.5	41.5	-4.6			37	
Adjusted Pat	4,117	3,615	3,682	-11%	2%	7,297	-11%
Extra-ordinary Items/Prior period	67.3	-31.7	42			10	
Net Profit	**4,184**	**3,584**	**3,724**	**-11%**	**4%**	**7,308**	**-12%**

Source: Company

Investments increase refers to deployment of idle cash in mutual funds

Debt increase of Rs 10b comprises Rs 1.4b on account of forex impact (is non cash) and rest is actual debt increase

Figure 2. Balance Sheet (in Rs Millions)

Sources of Funds	**Sept-11**	**Jun-11**
Shareholders funds		
Capital	21,500	21,499
Reserves and Surplus	245,100	248,726
Minority Interests	5,920	6,160
Loan Funds	238,630	254,498
	511,150	**530,883**
Application of Funds		
Fixed Assets (incl CWIP)	284,110	285,070
Investments	9,610	15,039
Goodwill on consolidation	15,060	15,086
Def tax assets	1,260	1,469
Stocks	152,610	152,338
Sundry debtors	18,180	19,540
Cash & bank balances	11,040	11,820
Loans and advances	75,850	80,572
Other current assets	77,030	79,361
Current assets, loans & adv	334,710	343,632
Liabilities	94,260	91,049
Provisions	39,340	38,365
Current liab and provisions	133,600	129,414
Net current assets	201,110	214,218
	511,150	**530,883**

Source: Company

Figure 3. Cash Flow Extract: As at Sep - 11 (in Rs Millions)

Cash flow form operating activities	11,130
Interest/div received	1,310
Change in long term debt	14,500
Interest paid	-12,740
Dividends paid	-5,010
Capex	-5,010

Source: Company

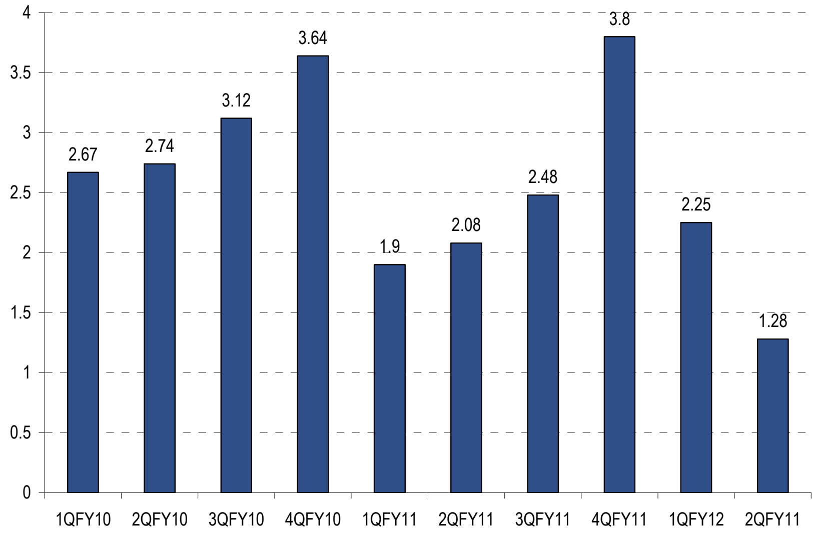
Weak Operating Performance, as expected

1.3 msf of gross sales in Q2 includes Gurgaon (sec - 91/92) - 0.4 msf, Indore plotted development - 0.2msf and mid-income homes of 0.7msf

Launches have been slow so far in the year…partly leading to lower sales momentum.

Company has indicated 6.5-7.5msf of launches in 2H across Mullanpur, Panchkula, Gurgaon, Lucknow & Bangalore (~1 msf group housing already launched)

Figure 4. DLF Sales Tracker (msf)



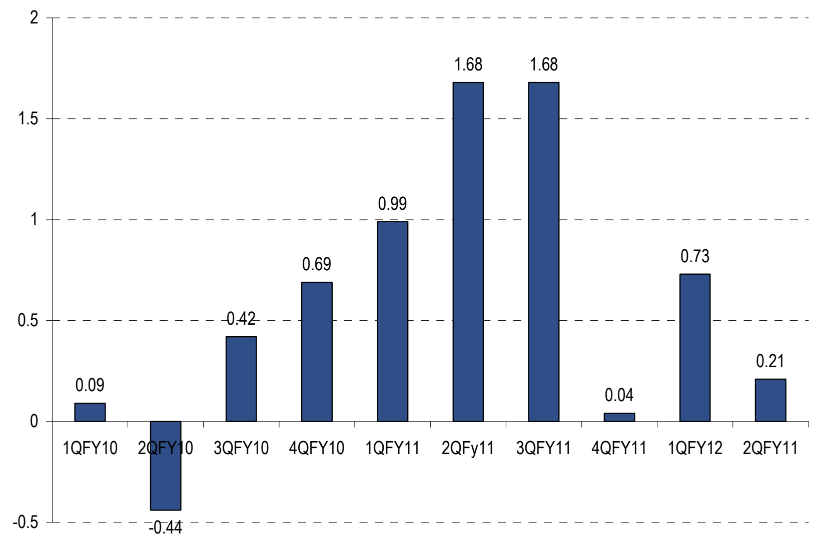
Source: Company

Net leasing dropped to ~0.2msf in Q2- led by cancellation of 0.4msf in Chennai property

Leasing has been relatively muted in 1H-0.9msf (gross 1.6msf). FY12 guidance of 2.5-3msf has been left unchanged

Increasing rental income annuity (~Rs. 3.9b for Q2 vs Rs 3.65b in Q1) is comforting

Figure 5. DLF Net Leasing Tracker* (msf)



Source: Company (* after taking into account adjustments and cancellations)

Tweak Estimates; New TP/NAV of Rs 271/345

We revisit our assumptions/estimates based on the macro environment, company disclosures and 1H-FY12 performance. We decrease our base NAV estimate by ~3% to Rs 345/share (vs. Rs 355 earlier). We maintain our valuation methodology - assume 50% probability of 15% price cut to arrive at average NAV of Rs 302 (vs. Rs 311 earlier). Key changes:

- Based on disclosures as at Sept-11, updated net debt and land bank.
- Cost of Capital of 15.3% vs 15.5% earlier. This incorporates cost of debt (12.75%); long-term D/E of 0.7x and beta of 1.5 based on Bloomberg.

Figure 6. Valuation Snapshot (in Rs/share)

Base NAV	**345**
NAV -15% price cut	258
Probability	50%
Blended NAV	**302**
Avg Disc to NAV	10%
Target Price	**271**

Source: Citi Investment Research and Analysis

Figure 7. DLF – Base NAV Summary (in Rs Millions)

Gross NAV Residential	628,522
Gross NAV Non-Residential	278,823
Total Gross NAV for Development business	**907,346**
Less: Amt outstanding for land	14,000
Less: Tax @ 25%	223,336
Less: Net Debt outstanding (ex-Promoter CCPS)	209,190
Add: Non Core asset sales	21,038
Less: Customer Advances	31,850
Net NAV for Development business	**450,007**
Add: Value of -	
Rent Yielding Assets (~24msf in total)- 60% stake valued	93,355
Other Businesses	26,250
Total Value	**569,611**
No. of Shares Outstanding (m)	1,651
Base NAV Per Share (Rs)	**345**

Source: Citi Investment Research and Analysis

Changes in Earnings

We have revisited our assumptions/estimates based on 1H performance, management commentary and disclosures and overall operating environment. We largely maintain our numbers till the EBITDA line but tinker our estimates on items like other income, interest expense, depreciation and minority interest and associate income. This results in earnings cut of ~2-6% across FY12E-FY14E.

Figure 8. Change in Earnings

	FY12E			FY13E			FY14E		
	New	Old	Change	New	Old	Change	New	Old	Change
Total Revenues (Rs m)	102,707	102,707	0%	116,165	116,165	0%	128,987	128,987	0%
EBITDA (Rs m)	46,291	46,291	0%	53,133	53,133	0%	58,814	58,814	0%
Net Profit (Rs m)	17,072	18,098	-6%	22,674	23,435	-3%	27,057	27,567	-2%
EPS (Rs)	10.06	10.66	-6%	13.36	13.80	-3%	15.94	16.24	-2%

Source: Citi Investment Research and Analysis estimates

Other key takeaways

- **Slow launches in Q2…-** Management highlighted that both Mullanpur and Panchkula were due for launch in Q2. Due to delayed approvals, they were pushed to Q3. Now the approvals are in place for them and for Lucknow and three should get launched by December.
- **…7-8msf of launches to come in 2H-** Launches typically gets bundled up in Q3 and Q4 for DLF due to festivities around this time. So 2H should be strong as they have listed a pipeline of 6.5-7.5msf (see Fig 9).

Figure 9. Upcoming Launches

Location	Asset Class	Area (msf)	Status
Mullanpur	Plots	1.0	Approvals in place
Panchkula	Plots	1.0-1.5	Approvals in place
Gurgaon	Plots	0.5	
Lucknow	Plots	1.5	Approvals in place
Gurgaon	Group Housing	1.5-2.0	
Bangalore	Group Housing	1	0.7msf launched already in Rajapura

Source: Company

- **Capex Updates-** Rs 1.4b was towards land replenishment in Q2 of the total capex spend of Rs 2.3b. In 1HFY12, Rs 3.7b land capex was made of the total Rs 6.1b. Land aggregation is only taking place in two locations largely – Mullanpur and some pockets in New Gurgaon. Management expects Rs 2.0-2.5b/quarter will be spent on land capex.

Current net debt is of ~Rs 225b- Company is targeting to reach Rs 190-195b by FY12 end

- **Rs 10b debt increase-** Forex impact of debt (USD 240m offshore loans in the books of Aman Resorts) was to the tune of Rs 1.4b (non cash). Rest is actual debt increase as divestments proceeds for delayed and certain payments came in typically in Sept. While the current net debt is of ~Rs 225b, company is targeting to reach Rs 190-195b by end of FY12.

- **Roadmap for asset sales in place-**
  - (1) All approvals are in place for Pune SEZ sale. Now delays are on account of documentation process between parties
  - (2) Noida IT park sale definitive agreement has been signed. However, post transaction closure, 50% cash flow will be milestone driven (as property is 50% leased currently) and remaining will come upfront in Q3
  - (3) Four bids have been received for Hospitality asset and is currently being evaluated
  - (4) For Phase II divestments of Rs 40b, company has list in place which includes 2-3 big ticket size assets but no further details were shared as of now.

Asset sales expected to yield cash flow of ~Rs 30b in FY12

  The first three, along with ~3.0msf of land FSI sales, is expected to yield cash flow of ~Rs 30b in FY12.

- **Working capital deteriorated in Q2** as (1) collections have been running behind schedule due to shortage of labour (ie construction linked installments) (2) launches have been slow

- Appellate hearing has begun for the IT tax demands on SEZ profits.

- Delivery of ~9.5msf in Ph-V Gurgaon in FY12– residual 10-15% collections are left while 15-17% outflow is yet to happen. For remaining deliveries (~3.5msf) expected in FY12, 35-40% collections are yet to be made.

- Vacancy is ~2.0msf of the total 24msf (specifically in 2-3 buildings).

DLF

Company description

DLF is one of India's oldest real estate developers. Established in Delhi in 1946, it has continued to expand and diversify its real estate businesses, and is among the largest developers in India. It has historically built its businesses in Delhi and adjoining areas, known as the National Capital Region (NCR). DLF has diversified into other geographic locations over the past few years. These expansions are spread across India, with a focus on the Northern India belt, Kolkata, Mumbai, Chennai, and a number of other large and rapidly growing cities. DLF enjoys a strong brand franchise with a good track record in execution and delivery. This is the flagship company of the KP Singh family, with the founders holding a 78.6% stake. It is one of India's largest developers, with a diversified asset portfolio and an emerging pan-India presence.

Investment strategy

We rate DLF as Buy (1) with a target price of Rs271. We view DLF as differentiated by: (a) Rent yielding assets with >Rs 15b annuity run-rate already in place - meaningfully higher than peers; (b) High quality land bank - particularly in Gurgaon/metros; (c) Track record of quality/execution. A pickup in the commercial segment should benefit DLF the most, while monetization of rent yielding assets at a later stage could unlock significant value. Also, overhang of DAL-DLF integration is out of the way. While liquidity appears slightly stretched for DLF, given its execution track record, growing rental income, and geographic-asset mix, we continue to believe the company is strongly positioned versus peers.

Valuation

Our Rs 271 target price is based on a 10% discount to our blended Sept-12E NAV of Rs 302. DLF has significant exposure to the NCR region. We believe chances of price cuts are quite probable, given the price hikes the region has seen since the last downturn. Hence, we have assigned 50% probability of potential 15% price cuts to arrive at our TP. This is in line with our valuation methodology for the sector. Our Sept-12E base NAV (ex-price cut) of Rs 345 incorporates Rs272 for the development portfolio and Rs72 for other asset holdings (mainly lease asset portfolio at Rs57). The lower discount vs. peers (10%-25%) is attributed to DLF's: 1) rich land bank vs peers; 2) superior business model and execution track record; and 3) strong rental annuity flow of >Rs15b/annum. Our Sept-12E base NAV is based on: 1) development portfolio of ~359 msf; 2) rental assets of ~24 msf; 3) cap rate of 10%-11% for commercial/IT Park, IT SEZs; 4) Increased cost of capital of 15.3%; and 5) a tax rate of 25%.

Risks

The key risks to our investment thesis on DLF are: 1) DLF's deleveraging remains contingent on non-core asset sales (2) Any delays in upcoming launches / slow response to launches could be detrimental (3) Slowdown in the IT/ITES industry could lead to a decline in demand for commercial real estate (4) execution delays further to what we have built in already (5) Slowdown in capital inflows or measures to regulate FDI in the real estate sector. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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DLF (DLF.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Surendra Goyal, CFA
Covered since June 1 2010

	Date	Rating	Target Price	Closing Price
1	1-Feb-09	1M	*240.00	177.20
2	1-Jun-09	*1L	*464.00	414.85
3	23-Aug-10	1L	*407.00	330.85
4	7-Feb-11	1L	*295.00	242.70
5	4-Aug-11	1L	*280.00	218.05
6	7-Oct-11	Stock rating system changed		
7	7-Oct-11	*1	280.00	218.45

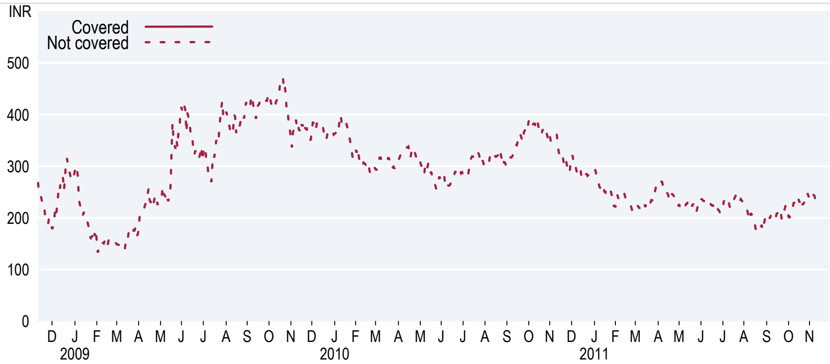
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

DLF (DLF.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Surendra Goyal, CFA
Covered since June 1 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 9 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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