Flashnote

HSBC Global Research

FIG
Real Estate
Equity – India

Unitech Ltd (UT IN)

Underweight (V)

Target price (INR)	20.00
Share price (INR)	21.20
Forecast dividend yield (%)	0.6
Potential return (%)	-5.1

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-24.3	-34.8	-37.4
Relative^ (%)	-17.9	-26.1	-28.4

Index^	BOMBAY SE SENSITIVE INDEX
RIC	UNTE.BO
Bloomberg	UT IN
Market cap (USDm)	1,001
Market cap (INRm)	55,426
Enterprise value (INRm)	73,710
Free float (%)	25

Note: (V) = volatile (please see disclosure appendix)

23 May 2012

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UW(V): Meeting update - FY13 focus on execution

- **Unitech expects to scale up execution by +30% during FY13, while maintaining new projects momentum steady**
- **Management guiding for EBITDA rebounding to 35% and FCF generation of INR13bn in FY13**
- **We maintain our conservative forecasts and await more visibility; retain UW(V) with TP of INR20**

Following are the key takeaways from our recent conversation with management. Please find details inside the note:

1) We sense management is keen to focus on execution to complete 12m sq ft of undelivered projects sold prior to FY09. Hence, in FY13, new launches will be flat at 8m sq ft

2) Unitech expects to make INR12-14bn of FCF during FY13 by spending INR12-13bn on construction. (HSBCe of INR11bn of FCF, unchanged. Refer to page 3)

3) Management expects EBITDA margins in FY13 to rebound sharply to 32-35% against a mere 16% in FY12. We remain less optimistic on low visibility and stay constant at 25%

4) Management expects improved funding environment to help it refinance its INR12bn repayment liability during FY13. This will allow it to plough back FCF into scaling up execution, although keeping absolute debt constant cINR50bn.

Overall, although management sounded upbeat on improving market demand and its ability to scale up execution, we remain sceptical of Unitech's ability to improve its EBITDA margins due to its limited control on cost inflation.

Retain UW(V) with a TP of INR20. Our target price of INR20 values Unitech at a 60% discount to its FY13e net asset value (NAV) of INR51. Our target price reflects our lower visibility on Unitech's execution scale up and our recent earnings estimate cut. At a 60% NAV discount, we value Unitech at bottom end of the peer trading range (25-60%). A combination of weak earnings, a deteriorating business environment, and the lack of share price catalysts suggests that Unitech may continue to trade at a lower valuation multiple.

Figure 1: Unitech Valuation snapshot

(INRm)	Sales	EBITDA margin (%)	PAT	EPS (INR)	EPS growth (%)	ROE	PB
FY11a	31,870	29.0	5,676	2.17	-14.3	5.2	0.5
FY12a	24,466	16.4	2,484	0.95	-56.4	2.1	0.5
FY13e	34,273	31.0	4,928	1.88	98.4	4.1	0.5
FY14e	41,444	26.7	6,177	2.35	25.3	4.9	0.4

Source: HSBC estimates

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	31,870	24,466	34,273	41,444
EBITDA	9,238	4,019	8,658	11,051
Depreciation & amortisation	-319	-434	-744	-881
Operating profit/EBIT	8,919	3,585	7,914	10,170
Net interest	-1,455	-1,229	-2,145	-2,145
PBT	8,483	4,397	7,728	9,517
HSBC PBT	8,483	4,397	7,728	9,517
Taxation	-2,704	-1,835	-2,550	-3,141
Net profit	5,676	2,484	4,928	6,177
HSBC net profit	5,676	2,484	4,928	6,177
Cash flow summary (INRm)				
Cash flow from operations	-1,419	17,338	-5,451	-410
Capex	-2,105	-1,270	259	533
FCF enterprise	-1,375	19,345	-1,088	3,761
Cash flow from investment	-3,507	-1,259	259	533
Dividends	-262	-328	-393	-459
Change in net debt	-2,241	-20,061	3,012	-1,146
FCF equity	-2,830	18,116	-3,233	1,616
Balance sheet summary (INRm)				
Tangible fixed assets	34,728	35,569	36,054	36,401
Current assets	230,241	225,002	234,907	243,908
Cash & others	4,509	21,090	18,079	19,225
Total assets	297,634	293,226	303,616	312,964
Gross debt	58,480	55,000	55,000	55,000
Net debt	53,971	33,910	36,921	35,775
Shareholders funds	115,836	118,334	123,262	129,438
Invested capital	261,662	241,021	254,422	262,625

Ratio, growth and per share analysis

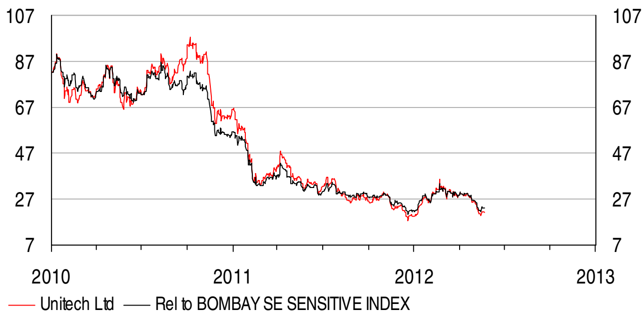
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	8.7	-23.2	40.1	20.9
EBITDA	-13.8	-56.5	115.4	27.6
EBIT	-14.0	-59.8	120.7	28.5
PBT	-6.2	-48.2	75.8	23.2
HSBC EPS	-14.3	-56.4	98.4	25.3
Ratios (%)				
Revenue/IC (x)	0.1	0.1	0.1	0.2
ROIC	2.5	0.8	2.1	2.6
ROE	5.2	2.1	4.1	4.9
ROA	2.4	1.1	2.2	2.5
EBITDA margin	29.0	16.4	25.3	26.7
Operating profit margin	28.0	14.7	23.1	24.5
EBITDA/net interest (x)	6.4	3.3	4.0	5.2
Net debt/equity	46.4	28.5	29.8	27.5
Net debt/EBITDA (x)	5.8	8.4	4.3	3.2
CF from operations/net debt		51.1		
Per share data (INR)				
EPS reported (fully diluted)	2.17	0.95	1.88	2.35
HSBC EPS (fully diluted)	2.17	0.95	1.88	2.35
DPS	0.10	0.13	0.15	0.18
NAV	44.27	45.11	46.99	49.34
NAV (adjusted)	0.00	0.00	0.00	0.00

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Premium/ (discount) to NAV	0.5	0.5	0.5	0.4
Premium/ (discount) to NAV (adj)				
PE*	9.8	22.4	11.3	9.0
FCF yield (%)	-7.1	45.5	-8.1	4.1
Dividend yield (%)	0.5	0.6	0.7	0.8

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 22 May 2012

HSBC

Unitech management meeting notes

Management guiding for INR12bn of FCF during FY13

Unitech is currently budgeting to spend INR12-15bn on construction (implied 7-8m sq ft) during FY13, which will help it collect customer advances of cINR40bn and thereby generate operational cash flows of INR25bn. An interest charge of INR7bn and corporate expenses of INR5bn, suggests the company expects to make a free cash flow of INR12bn during the year.

Figure 2: Unitech management guidance comparison with our existing estimates

(INRbn)	FY13e	
	HSBCe	Management guidance
Customer advances	39	40
Construction cost	13	12
Admin exp	5	5
Tax outflow	3	3
Total cost	21	20
Net operational cash	18	20
Less int exp	7	7
FCF	**11**	**13**
New launches	9.5	8.0
Avg selling price	5,713	

Source: Company data, HSBC estimates

HSBC comment: Given the current scenario of some of the top management time being consumed by the 2G spectrum allocation issue, we anticipate execution scale up will be a big challenge. Our estimates factor Unitech generating FCF of INR11bn (15% lower than management guidance).

Unitech expects EBITDA margins to rebound to 35%

Adjusting for a broader inflation linked cost escalation; Unitech expects EBITDA margins to rebound to 35% during FY13. Rising labour costs were cited as a key concern, though not a deterrent.

HSBC comment: Management had guided for similar margins during FY11 and FY12. However, it could do so only in three out of the past 10 quarters. With commodity price inflation still holding up, we expect the EBITDA margin rebound to be lower at 25%.

Focus on execution, unlikely to witness a ramp up in new launches

Management during FY13 expects to equal its previous peak execution of 8m sq ft achieved during FY08. With focus primarily remaining on construction scale up, new launches will remain subdued and could remain around 7-8m sq ft (similar to FY12).

HSBC comment: We agree with Unitech's business plans to focus on execution, as the company has an execution backlog of c40m sq ft of which c 20% relates to projects launched prior to FY09. We expect Unitech to sell c9.5m sq ft during FY13.

FCF will be used for execution scale up, so debt reduction unlikely

Unitech highlighted it has witnessed a marked improvement in bank financing over the past few months. Coupled with a renewed thrust on increasing construction momentum; it will look at refinancing the INR12bn of debt up for repayment during FY13.

Our comment: With net debt to equity at 0.3, it does not ring alarm bells if Unitech chooses to utilise FCF for growth instead of debt repayment. However, Indian real estate players in the past have re-invested FCF in excessive new land purchases, which if done by Unitech could be detrimental to shareholder value creation as it already has land bank sufficient for more than 20 years of development.

Valuation and risks

Investment summary

A spate of weak quarterly results (five quarters in a row) has lowered visibility on core operating performance. We believe the operating margin structure on Unitech's development projects is far lower than warranted despite consistent selling price inflation in the market. This, coupled with potential pressure on new sales volumes in a weak operating environment and a delayed execution cycle (12-18 months across project categories), exerts pressure on earnings and valuation. We expect Unitech to report a modest c3% earnings CAGR over FY11-14. We look forward to seeing management's focus on the core real estate business improving after the 2G spectrum issue court trials are over. This, in our view, could act as a share price catalyst over the next 12-18 months.

HSBC

Retain UW(V) with a TP of INR20

Our target price of INR20 values Unitech at a 60% discount to its FY13e net asset value (NAV) of INR51. At a 60% NAV discount, Unitech is valued at the high end of the NAV discount range of 20-60% for its peer group. We do not include the value of its telecom business in our target valuation, as we foresee limited visibility on the monetisation of Unitech's stake in the business. A combination of weak earnings, a deteriorating business environment and the lack of share price catalysts suggests that Unitech may continue to trade at a lower valuation multiple.

Figure 3: Unitech valuation table

	FY13e	
	INRbn	**Per share**
Projects NAV	166	63
UCP	9	4
Amusement park	4	2
Hospitality/ Facility management/ Industrial parks	5	2
Transmission towers / Construction/ Others	2	1
Gross NAV	**187**	**72**
Less: Net debt	(37)	(14)
Less: O/S land and Statutory payments	(18)	(7)
Net Asset Value (real estate)	**132**	**51**
Net Asset Value (Unitech group)	**132**	**51**
Less: NAV discount	(79)	(30)
Target value	**53**	**20**

Source: HSBC Research

Ratings rationale

Under our research model, with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for India stocks of 11%. Our target price for Unitech implies a potential return of -5.1% (including a forecast dividend yield of 0.6%), below the Neutral band; therefore, we retain our Underweight (V) rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks to our investment view

- The key downside risk is the 2G spectrum allocation issue becoming protracted, which will likely distract management's focus.
- Better than estimated execution improving its cash flow cycle

Disclosure appendix

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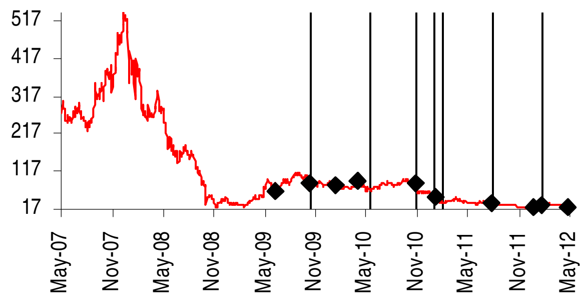
Share price and rating changes for long-term investment opportunities

Unitech Ltd (UNTE.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral (V)	02 November 2009
Neutral (V)	Overweight (V)	01 June 2010
Overweight (V)	Neutral (V)	15 November 2010
Neutral (V)	Underweight (V)	24 January 2011
Underweight (V)	Overweight (V)	15 February 2011
Overweight (V)	Neutral (V)	15 August 2011
Neutral (V)	Underweight (V)	15 February 2012
Target Price	**Value**	**Date**
Price 1	65.00	29 June 2009
Price 2	85.00	02 November 2009
Price 3	83.00	01 February 2010
Price 4	91.00	19 April 2010
Price 5	94.00	22 April 2010
Price 6	87.00	15 November 2010
Price 7	50.00	24 January 2011
Price 8	31.00	15 August 2011
Price 9	24.00	15 January 2012
Price 10	25.00	15 February 2012
Price 11	20.00	16 May 2012

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
UNITECH LTD	UNTE.BO	21.20	22-May-2012	4

Source: HSBC

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