Emkay

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DLF

Concerns linger

Company Update

June 30, 2011

Reco	**Previous Reco**
Reduce	NA
CMP	**Target Price**
Rs 211	Rs 203

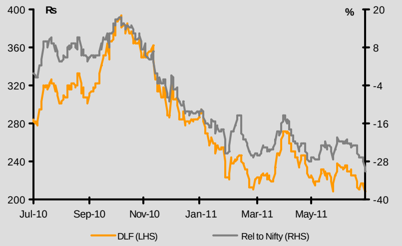
EPS change FY11E/12E (%)	NA
Target Price change (%)	NA
Nifty	5,647
Sensex	18,846

Price Performance

(%)	1M	3M	6M	12M
Absolute	(12)	(20)	(27)	(27)
Rel. to Nifty	(13)	(18)	(21)	(31)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Real Estate
Bloomberg	DLFU@IN
Equity Capital (Rs mn)	3395
Face Value(Rs)	2
No of shares o/s (mn)	1698
52 Week H/L	397/207
Market Cap (Rs bn/USD mn)	357/7,987
Daily Avg Volume (No of sh)	1968740
Daily Avg Turnover (US$mn)	10.3

Shareholding Pattern (%)

	Mar-11	Dec-10	Sep-10
Promoters	78.6	78.6	78.6
FII/NRI	15.9	15.8	15.9
Institutions	0.4	0.5	0.8
Private Corp	1.3	1.5	1.1
Public	3.8	3.7	3.7

Source: Capitaline

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- Exit to PE investor, post-merger structure and blockage of capital in assets with low visibility have stretched DLF's balance sheet
- Core-business cash generation will go towards debt servicing; only divestment of non-core assets will lead to meaningful reduction in company's debt
- DLF's plotted-development focused strategy plays low on value economics, but is a smart respite given the current economic environment and company's financial health
- Valuing the company on SOTP-basis with NAV at Rs 203 with Reduce rating. Post-crisis, the stock trades at lowest P/BV justified by lowest ROE and highest D/E ratio

Cash generation from core operations should lead to marginal debt reduction in FY12E

Our estimations show that company should generate net cash inflow of ~ Rs10 bn from core operations in FY12E, which it can utilize for debt redemption. A substantial portion of cash generation should come from inventory reduction with high-value residential projects in DLF Phase V nearing completion and new launches being plotted developments (entailing lower development costs and thereby carrying lower inventory cost). A large part of debt reduction can come only through cash generation from divestment of non-core assets or monetization of its leased assets.

Thumbs-up to the company's change in business strategy

Given DLF's stretched financials, we are positive on the company's strategy to focus on plotted development vis-à-vis group housing development. This strategy will not only mitigate the systematic risk pertaining to lower absorption rate and cost inflation, but will also put less stress on company's balance sheet. The project-launch strategy clearly focuses on capitalizing on the success of previous launches made in the same land parcel thus giving some certainty towards absorption

PE investor exit and post-merger structure is value dilutive

Exit to PE investors in DAL (DLF Assets Ltd) and post-merger issuance of CCPS (Compulsory convertible preference shares) to DLF promoters has burdened DLF with costs (interest and preference share dividend) far higher than the incremental revenue to be earned in terms of rentals. The merger will be value dilutive in the medium-term till monetization through REIT listing takes place.

Expect sales bookings of 7.4 msf of Rs 32.6bn in FY12E

We believe the company will have sales bookings of 7.4 msf in FY12E, of which 1.7 msf will be from its current inventory of ~3.0 msf and the balance 5.7msf is likely to come from new launches of 10msf in FY12E. These sales bookings are estimated to be worth Rs 32.6bn, with nearly 1/3rd of the same coming from old projects and the balance from new launches in FY12E.

Financials (Consolidated) **(Rs Mn)**

YE-Mar	Net Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY10	74,229	35,116	47.3	17,198	10.7	(59.4)	6.3	19.8	16.1	1.5
FY11P	95,610	37,801	39.5	16,671	9.3	(13.3)	5.9	22.8	15.5	1.5
FY12E	98,719	40,772	41.3	15,591	9.2	(0.9)	5.8	23.0	14.0	1.4
FY13E	102,237	42,174	41.3	17,891	10.5	14.8	6.4	20.0	13.2	1.3

Focus on plotted development apt for DLF over the next 12-18 months; mitigates both - systematic and unsystematic risks

We believe moving to plotted development is the smart strategy in the current environment given the company's inability to absorb incremental inventory and external factors like inflationary cost uncertainties and lower housing demand in a high interest rate scenario.

Unlike in a group housing project, the company is under no compulsion to deliver the whole plotted development project even if the absorption rate is lower in the current high interest cost scenario.

Also, due to low development cost in plotted development, the working capital overhang also reduces. Given its stretched balance sheet, DLF's capability to finance incremental net working capital is at its lowest.

Lastly, most of DLF's large value projects viz. Magnolia, The Park Place and The Bellaire are nearing completion and hence unlike in FY11, will generate relatively low cash in FY12. To meet its debt servicing costs in FY12 with least investment towards construction, plotted-development is the best segment to be in.

Plotted Development

Advantages

- Shorter cash conversion cycle
- Development cost uncertainties are passed on to the customer
- Lesser approvals required than group housing development
- Low management bandwidth required towards project development
- Relatively higher flexibility in project launches
- Lower capital blockage if the project absorption rate is lower

Disadvantages

- Relatively smaller target market
- Lower saleable area than group housing development due to lower FSI / FAR utilization

FY12E Planned Launches

Segment / Projects	Area (msf)	Location
Group Housing		
Super Luxury	1.0	Gurgaon
Mid Income	1.0	Gurgaon
Total	**2.0**	
Plotted Development		
Garden City Phase 2	2.0 – 3.0	Indore
New Town Heights Phase 2	3.0 – 4.0	Gurgaon
Hyde Phase 2	1.5 - 2.0	Chandigarh
DLF Valley Phase 3	1.5 - 2.0	Panchkula
Total	**8.0 - 11.0**	
Grand Total	**10.0 - 13.0**	

The overall project economics work in favor of Group Housing Project in a stable economic scenario. For every 10 acres of mid-income plotted development, the company loses ~Rs 400mn on the value creation (based on certain assumptions) over group housing development.

Group Housing v/s Plotted Development (A typical example)

	Unit	Group Housing	Plotted
Land Area	acres	10	10
Land Area	msf	0.4	0.4
FSI / FAR (Typical)	times	2.0	0.7
Saleable Area	msf	0.9	0.3
Pricing	Rs / sf	4500	6075
Revenue	Rs mn	3920	1852
Development Cost	Rs / sf	1800	500
Development Cost	Rs mn	1568	152
Gross Profit	Rs mn	2352	1700
Development Timeline	Year(s)	3	1
Opportunity Gain @ 11%	Rs mn	129	395
Net Revenue	**Rs mn**	**2482**	**2094**

Overall value economics favor Group Housing Development

Divestment of non-core assets or monetization of leased assets alone will lead to meaningful debt reduction

Our cashflows estimates for FY12E indicate net cash inflow of Rs 54.5bn from the rentals and ongoing residential projects. Assuming sales bookings of 5.7msf from new project launches (and 1.7msf from inventory of ongoing projects) of 10msf with a value of Rs 20.4bn, the net cash inflow would be Rs 3.7bn in FY12E. In all, the company will generate a total cash inflow (post construction cost) of Rs 58.1bn.

Deducting the fixed operating and financing costs as well as estimated variable cash outflow towards taxes, the net cash flow available for debt repayment would be Rs 10.1bn. We have estimated Rs 14.4bn reduction in debt, with additional Rs 2.3bn coming from reduction of cash-in-hand and balance Rs 2.1bn from Other Income.

Incremental rentals in FY11 stood at Rs 5.45bn against cash outflows of Rs 4.25bn and Rs 1.45bn towards servicing of incremental debt and newly issued CCPS to promoters respectively. On an aggregate basis, the merger was value dilutive to the tune of Rs 0.25bn in FY11. Company is losing cash in the short-term in anticipation of benefiting from the yield spread of nearly 400 bps through REIT listing in Singapore. But the same taking place will lead to conversion of CCPS, leading to 40% of value going to the DLF promoters. Till then, DLF will continue to bear interest cost on the incremental debt as well as dividend cost on CCPS issued.

Thus, we believe only divestment of non-core assets or monetization of leased assets through REIT listing will lead to debt reduction. We expect a similar scenarios in FY13E also, if the company doesn't divests its non-core assets.

Cash Flow Estimations in FY12E	Rs Mn
Net Rentals	13300
Net Cash Inflows from Ongoing Development Projects	38701
Other Operating Income	2583
Cash Inflow Visibility	**54501**
Net Cash Inflows from New Launches Planned	3651
Total Cash Inflow in FY12 E	**58151**
Fixed Operation Costs	11888
Interest Costs	25800
Preference Dividend Costs	1437
Equity Dividend Costs (Past Trend)	3978
Fixed Cash Outflows in FY12 E	**43103**
Tax Outflow Estimates	4995
Net Cash flow available for Debt Deduction	**10136**

Assumptions

- Net cash inflows from ongoing development projects also includes cash inflows from sale of 1.7 msf of inventory
- Net cash inflows from planned new projects is estimated by assuming sale of 5.7 msf from the launch of 10 msf in FY12
- Non-core asset sales are not considered in FY12
- Other Operating Income comprises of income from Power Utilities, Restaurants , etc
- Company does not incur any significant construction cost on rent assets in FY12 (as stated by the management.)

Valuations

We have valued DLF on SOTP basis by assigning enterprise value to the company's assets. We have valued the merged entity DCCDL separately, considering DLF promoters could convert its CCPS into 40% stake in the entity.

DLF's leased assets valued at a cap rate of 11%, Mumbai land and land bank in Gurgaon Phase V valued at Rs 7000 / sf provides an aggregate value of Rs 310bn, which, post net debt deduction of Rs 214bn, is equal to 27% of the current market capitalization.

We have taken 40% discount to the current CWIP considering that a part of it was through DAL merger which was at much higher valuations and also due to lower visibility on the commercial projects.

Land Bank, valued at Rs 282bn, forms 82% of the Equity NAV of 344bn

The net NAV / share come to Rs 203, giving a potential downside of 4% from the CMP.

	Rs Mn
DCCDL	137598
Ongoing Residential Projects	52299
Ongoing Commercial Projects	73006
Land Bank	282119
Other Assets / (Liabilities)	13188
Gross Asset Value	**558209**
Less: Net Debt	214240
Net Asset Value	**343969**
Equity NAV / Share	**203**

We would upgrade our rating

- When there is divestment of non-core assets leading to significant reduction in debt
- Sales bookings surpasses our estimates for FY12E in terms of value and hence giving better visibility of cash generation
- Reduction in systematic risks having meaningful impact on company's cashflows
- Monetisation of leased assets and reduction of debt with the cash generated

Key Financials – Quarterly (Consolidated)

Rs mn	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	YoY (%)	QoQ (%)	FY11P	FY10	YoY (%)
Revenue	**19,944**	**20,290**	**23,690**	**24,799**	**26,831**	34.5	8.2	**95,610**	**74,214**	28.8
Expenditure	**9,944**	**10,490**	**14,131**	**13,020**	**20,169**	102.8	54.9	**57,809**	**39,204**	47.5
as % of sales	*49.9*	*51.7*	*59.6*	*52.5*	*75.2*			*60.5*	*52.8*	
Cost of Sales	6,071	7,340	10,142	9,526	15,995	163.4	67.9	43,003	25,841	66.4
as % of sales	*30.4*	*36.2*	*42.8*	*38.4*	*59.6*			*45.0*	*34.8*	
Employee Cost	1,191	1,290	1,622	1,338	1,472	23.6	10.0	5,721	4691	22.0
as % of sales	*6.0*	*6.4*	*6.8*	*5.4*	*5.5*			*6.0*	*6.3*	
Other expenditure	2,682	1,860	2,368	2,156	2,703	0.8	25.4	9,086	8672	4.8
as % of sales	*13.4*	*9.2*	*10.0*	*8.7*	*10.1*			*9.5*	*11.7*	
EBITDA	**10,000**	**9,800**	**9,559**	**11,780**	**6,662**	(33.4)	(43.4)	**37,801**	**35,010**	8.0
Depreciation	947	1,500	1,540	1,612	1,657	75.0	2.8	6,309	3,247	94.3
EBIT	**9,053**	**8,300**	**8,019**	**10,168**	**5,005**	(44.7)	(50.8)	**31,492**	**31,763**	(0.9)
Other Income	1,518	1,320	1,509	1,143	1,866	23.0	63.3	5,838	4,328	34.9
Interest	3147	3880	4338	4272	4557	44.8	6.7	17,047	11,077	53.9
PBT	**7,424**	**5,740**	**5,190**	**7,039**	**2,314**	(68.8)	(67.1)	**20,283**	**25,014**	(18.9)
Total Tax	2,362	1,650	734	2,026	156			4,566	6,942	
Adjusted PAT	**5,062**	**4,090**	**4,456**	**5,013**	**2,159**	(57.4)	(56.9)	**15,718**	**18,072**	(13.0)
(Profit)/loss from JV's/Ass/MI	873	-20	69	284	-349			-16	745	
APAT after MI	**4,189**	**4,110**	**4,387**	**4,729**	**2,508**	(40.1)	(47.0)	**15,734**	**17,327**	(9.2)
Extra ordinary items	75	0	0	0	937			937	(75)	
Reported PAT	**4,264**	**4,110**	**4,387**	**4,729**	**3,445**	(19.2)	(27.1)	**16,671**	**17,253**	(3.4)
Reported EPS	**2.5**	**2.4**	**2.6**	**2.8**	**2.0**			**9.8**	**10.3**	

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	50.1	48.3	40.4	47.5	24.8	(2,531)	-2267	39.5	47.2	-764
EBIT	45.4	40.9	33.9	41.0	18.7	(2,674)	-2235	32.9	42.8	-986
EBT	37.2	28.3	21.9	28.4	8.6	(2,860)	-1976	21.2	33.7	-1249
PAT	21.0	20.3	18.5	19.1	9.3	(1,166)	-972	16.4	24.4	-791
Effective Tax rate	31.8	28.7	14.1	28.8	6.7	(2,510)	-2206	26.8	62.7	-3589

Financials (consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
Net Revenue	**74229**	**95610**	**98719**	**102237**
Growth (%)	*(26.0)*	*28.8*	*3.3*	*3.6*
Expenditure	**39113**	**57810**	**57948**	**60063**
Cost of Sales	25795	43003	43548	43816
Employee Cost	4668	5721	6279	6543
Other Exp	8650	9086	8121	9705
EBITDA	**35116**	**37801**	**40772**	**42174**
Growth (%)	*(37.2)*	*7.6*	*7.9*	*3.4*
EBITDA margin (%)	***47.3***	***39.5***	***41.3***	***41.3***
Depreciation	3249	6309	6308	6343
EBIT	**31867**	**31492**	**34463**	**35830**
EBIT margin (%)	***42.9***	***32.9***	***34.9***	***35.0***
Other Income	4280	5838	3575	3575
Interest expenses	11100	17047	17452	16293
PBT	**25046**	**20283**	**20586**	**23112**
Tax	**7023**	**4566**	**4995**	**5221**
Effective tax rate (%)	*28.0*	*22.5*	*24.3*	*22.6*
Adjusted PAT	**18024**	**15718**	**15591**	**17891**
Growth (%)	*(60.1)*	*(12.8)*	*(0.8)*	*14.8*
Net Margin (%)	***24***	***16***	***16***	***17***
(Profit)/loss from JVs/Ass/MI	(116)	(16)	0	0
Adj. PAT After JVs/Ass/MI	18140	15734	15591	17891
E/O items	(942)	937	0	0
Reported PAT	**17198**	**16671**	**15591**	**17891**
Growth (%)	*(61.5)*	*(3.1)*	*(6.5)*	*14.8*

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
Equity share capital	62,593	21,498	21,498	21,498
Reserves & surplus	241,734	241,823	252,002	264,482
Net worth	**304,327**	**263,321**	**273,500**	**285,980**
Minority Interest	**6,278**	**5,752**	**5,752**	**5,752**
Secured Loans	193,016	239,903	201,742	185,242
Unsecured Loans	23,751	0	23,751	23,751
Loan Funds	**216,766**	**239,903**	**225,493**	**208,992**
Net deferred tax liability	2,515	(1,633)	(560)	518
Total Liabilities	**529,886**	**507,343**	**504,185**	**501,242**
Gross Block	178,845	179,737	180,737	181,737
Less: Depreciation	13,265	19,572	25,880	32,224
Net block	**165,580**	**160,165**	**154,857**	**149,513**
Capital work in progress	111,288	121,677	122,677	123,677
Goodwill	12,680	13,840	13,840	13,840
Investment	**55,052**	**9,958**	**9,958**	**9,958**
Current Assets	**273,058**	**332,717**	**285,295**	**290,765**
Inventories	124,806	150,388	136,733	136,022
Sundry debtors	16,190	17,257	16,056	16,730
Cash & bank balance	9,282	13,461	11,113	11,519
Loans & advances	75,933	72,712	66,976	69,789
Other current assets	46,847	78,900	54,418	56,704
Current lia & Prov	**87,771**	**131,014**	**82,442**	**86,512**
Current liabilities	46,370	92,251	46,030	48,100
Provisions	41,402	38,764	36,412	38,412
Net current assets	**185,286**	**201,703**	**202,853**	**204,253**
Total Assets	**529,886**	**507,343**	**504,185**	**501,242**

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
PBT (Ex-Other income)	16432	11426	13039	15565
Depreciation	3249	6309	6308	6343
Interest Provided	11100	17047	17452	16293
Other Non-Cash items	0	0	0	0
Chg in Working Cap	50020	(12239)	(3497)	(995)
Tax paid	(7023)	(4566)	(4995)	(5221)
Operating Cashflow	**73779**	**17977**	**28308**	**31986**
Capital expenditure	134141	12443	2000	2000
Free Cash Flow	**(60361)**	**5534**	**26307**	**29986**
Other income	4280	5838	3575	3575
Investments	(41027)	45094	0	0
Investing Cashflow	**(36747)**	**50932**	**3575**	**3575**
Equity Capital Raised	45591	(57677)	(5412)	(5412)
Loans Taken / (Repaid)	53565	23136	(14410)	(16501)
Interest Paid	(11100)	(17047)	(17452)	(16293)
Dividend paid (incl tax)	3509	3973	3972	3972
Income from investments	0	0	0	0
Others	2870	(4673)	1072	1078
Financing Cashflow	**94434**	**(52288)**	**(32230)**	**(33156)**
Net chg in cash	**(2674)**	**4178**	**(2347)**	**406**
Opening cash position	11956	9282	13461	11113
Closing cash position	**9282**	**13461**	**11113**	**11519**

Key Ratios

Y/E, Mar	FY10	FY11P	FY12E	FY13E
Profitability (%)				
EBITDA Margin	47.3	39.5	41.3	41.3
Net Margin	24.3	16.4	15.8	17.5
ROCE	6.8	6.1	6.8	7.1
ROE	6.3	5.9	5.8	6.4
RoIC	9.3	8.8	9.5	10.0
Per Share Data (Rs)				
EPS	10.7	9.3	9.2	10.5
CEPS	12.0	13.5	12.9	14.3
BVPS	144.4	144.4	150.4	157.8
DPS	2.0	2.0	2.0	2.0
Valuations (x)				
PER	19.8	22.8	23.0	20.0
P/CEPS	17.5	15.6	16.4	14.8
P/BV	1.5	1.5	1.4	1.3
EV / Sales	7.7	6.3	5.9	5.5
EV / EBITDA	16.1	15.5	14.0	13.2
Dividend Yield (%)	0.9	0.9	0.9	0.9
Gearing Ratio (x)				
Net Debt/ Equity	0.7	0.9	0.8	0.7
Net Debt/EBIDTA	0.6	0.8	0.7	0.6

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