

DLF

A fresh start of sorts

India Equity Research | Real Estate

DLF's operations continue to improve as: a) It restarted sales from November 2017 (halted since May 2017 due to RERA uncertainties); net bookings stood at INR4.8bn and will translate into revenue in Q4FY18; b) Collections from these sales will aid cash flows going ahead; and c) Deleveraging process has started with the promoters infusing ~INR90bn funds; the company expects Devco to become net debt free by FY19 end post infusion of balance promoter funds/QIP, which will ease DLF's access to and cost of capital. The company will now focus on liquidating inventory in the high-end Gurgaon residential market apart from scaling up its fairly well balanced commercial/retail portfolio. Sales pick up in Devco along with ramp up in leasing portfolio will boost cash flow generation, in our view. Pending clarity on proposed deconsolidation of DCCDL, we maintain our estimates and 'BUY' recommendation with a target price of INR273.

Leverage metrics improve

Post ~INR90bn fund infusion by promoters, Devco's net debt has declined to INR55bn; post balance fund infusion by promoters/QIP, management expects Devco to become net debt free by FY19 end. This will reduce the cost of capital and cash burn (from INR9-10bn currently to INR6-7bn over next couple of quarters). Lowering of interest costs and pick up in sales can materially improve cash flows by FY19 end since almost the entire debt then will pertain only to the rental portfolio, which is performing well.

Focus on NCR residential segment

DLF reopened its sales from November 2017 and garnered net sales of INR4.8bn during Q3FY18. Balance sheet improvement will provide significant operational flexibility to DLF in its future plans since it can focus on the high-end residential segment in NCR and on liquidating its ~INR150bn inventory over next couple of years. While the current demand environment in NCR remains weak, any demand recovery will act as a catalyst for the stock, in our view.

Outlook and valuations: On an improving trajectory; maintain 'BUY'

We anticipate gradual uptick in DLF's operations in coming quarters. We expect the company to be a key beneficiary of ongoing consolidation in the sector and believe that its attractive rental portfolio and improving balance sheet will hold it in good stead going ahead. Maintain 'BUY' with TP of INR273.

Financials

(INR mn)

Year to March	Q3FY18	Q3FY17	% chg	Q2FY18	% chg	FY17	FY18E	FY19E
Revenues	16,937	20,579	(17.7)	15,877	6.7	82,212	75,599	89,086
EBITDA	7,013	9,578	(26.8)	7,869	(10.9)	34,333	35,443	41,985
Net Profit	41,003	976	NA	195	NA	2,855	3,030	7,639
EPS (INR)	23.0	0.5	NA	0.1	NA	1.6	1.7	4.3
P/E (x)						138.1	130.1	51.6
P/B (x)						1.6	1.6	1.6
ROE (%)						2.9	1.2	3.1

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Equalweight

MARKET DATA (R: DLF.BO, B: DLFU IN)

CMP	: INR 221
Target Price	: INR 273
52-week range (INR)	: 274 / 139
Share in issue (mn)	: 1,784.1
M cap (INR bn/USD mn)	: 394 / 6,087
Avg. Daily Vol.BSE/NSE('000)	: 10,941.0

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	74.9	74.9	74.9
MF's, FI's & BK's	1.5	1.3	1.1
FII's	17.0	16.7	17.2
Others	6.6	7.1	6.7
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Real Estate Index
1 month	(9.7)	(4.9)	(7.6)
3 months	(1.1)	0.6	0.3
12 months	54.0	16.7	65.1

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Management call highlights

1. **Q3FY18 performance:** DLF had halted sales beginning May 2017 (citing RERA compliance), which it restarted since November 2017. Gross sales during the quarter stood at INR6.7bn, while net sales stood at INR4.8bn. However, with these sales not meeting collection threshold (expected in Q4FY18), they didn't translate into revenues during Q3FY18. Notional pre-tax gain of INR86bn on account of stake sale in DCCDL boosted profitability.
2. **Q3FY18 revenue** of INR16.9bn (down 18% YoY, up 7% QoQ) was driven by POCM-based revenue recognition in ongoing projects. EBITDA margin, at 41.4% fell 510bps YoY and 820bps QoQ.
3. DLF promoters have received ~INR89bn towards the secondary sale of CCPS to GIC and ~INR16bn from buyback of CCPS by DCCDL. DLF has allotted CCDs/warrants aggregating to ~INR113bn to promoters. The promoters have already infused ~INR90bn by subscribing to CCDs/warrants; balance consideration will be received over next 18 months.
4. **Net debt:** Till date, the company has repaid INR71bn loans from promoter funds. Consequently, overall net debt has declined to ~INR216bn (INR268bn in Q2FY18). Of this, Devco has INR55bn net debt with the balance pertaining to DCCDL.

By FY19 end, management expects Devco to be net debt free, while DCCDL's net debt will remain at more or less same levels.

5. INR93bn inter-company loan will be payable by the DLF Group to DCCDL; this will be via sale of certain rental assets (INR3-3.5bn annual rentals) and land parcels earmarked for commercial use.
6. Management expects cash losses to decline going ahead, driven by lower interest costs. Assuming no improvement in sales, it expects cash losses at ~INR6-7bn per quarter over next couple of quarters.
7. **Ongoing projects:** DLF expects to complete most of its ongoing residential projects over next one year. The company estimates unsold inventory worth ~INR150bn in these projects (~INR87bn in Phase V) and expects to incur ~INR20-21bn towards pending construction cost. It has ~INR25bn of pending receivables from sales already done in these projects.
8. **DCCDL will be treated as a joint venture (JV)** post the deal, and hence DLF will only account for its share of earnings; DCCDL's P&L statement and balance sheet will be de-consolidated from DLF.
9. No immediate new launches are planned, except the ~7msf Midtown project (Central Delhi, JV with GIC). The company will launch the project only after significant level of completion has been achieved.
10. **Focus on high-end ready-to-move-in residential properties in NCR:** In the short term, DLF will continue to focus on completing its ongoing residential projects and be prepared with ready-to-move-in inventory to be sold once demand revives. Over medium to long term, it intends to focus on:
 - **NCR market:** DLF intends to remain a predominantly NCR play, going ahead.

- **Ready-to-move-in inventory:** In the post RERA environment, DLF intends to shift its sales strategy from the current pre-sales model to sales of ready-to-move-in inventory. However, this may lead to some strain on cash flows.

We believe this strategy means its future operations will be heavily dependent on the high-end Gurgaon residential market, which is currently sluggish. DLF has unsold inventory of ~INR150bn, which we believe will take around four years to get liquidated. Any uptick in the market (especially absorption levels) will be key driver for the stock over medium term. We believe DLF's strong brand, revamped balance sheet and relative lack of competition in the NCR market will hold it in good stead, even if near term operations remain subdued.

Financial snapshot

(INR mn)

Year to March	Q3FY18	Q3FY17	% change	Q2FY18	% change	YTD FY18	FY18E	FY19E
Net revenues	16,937	20,579	(17.7)	15,877	6.7	53,291	75,599	89,086
Direct expenses	5,946	7,294	(18.5)	5,079	17.1	19,661	28,158	34,383
Staff costs	1,127	1,017	10.8	747	50.8	2,657	3,053	3,237
Other expenses	2,851	2,691	6.0	2,182	30.6	7,060	8,944	9,481
Total expenditure	9,924	11,001	(9.8)	8,008	23.9	29,379	40,156	47,101
EBITDA	7,013	9,578	(26.8)	7,869	(10.9)	23,913	35,443	41,985
Depreciation	1,780	1,420	25.3	1,484	19.9	4,713	5,988	6,080
Other income	1,615	1,200	34.6	1,636	(1.3)	4,887	6,473	6,538
Interest	8,565	7,586	12.9	7,946	7.8	24,338	30,821	30,445
Add: Exceptional items	85,693	-	-	-	-	85,693	-	-
Profit before tax	83,976	1,771	NA	75	NA	85,442	5,106	11,999
Provision for taxes	42,876	516	NA	(159)	NA	42,896	1,277	3,360
PAT	41,100	1,256	NA	234	NA	42,546	3,830	8,639
Minority interest	(207)	(7)	NA	16	NA	(174)	800	1,000
Associate profit share	19	(267)	NA	(108)	NA	(211)	-	-
Reported profit	41,003	976	NA	195	NA	42,317	3,030	7,639
Diluted shares (mn)	1,784	1,784		1,784		1,784	1,784	1,784
Diluted EPS (INR)	22.9	0.5	NA	0.1	NA	23.7	1.7	4.3
Adjusted Diluted EPS	22.8	0.5	NA	0.1	BA	23.6	1.7	4.3
as a % of net revenues								
Cost of construction	35.1	35.4		32.0		36.9	37.2	38.6
Employee cost	6.7	4.9		4.7		5.0	4.0	3.6
Other expenses	16.8	13.1		13.7		13.2	11.8	10.6
Total expenses	58.6	53.5		50.4		55.1	53.1	52.9
EBITDA	41.4	46.5		49.6		44.9	46.9	47.1
Depreciation	10.5	6.9		9.3		8.8	7.9	6.8
EBIT	30.9	39.6		40.2		36.0	39.0	40.3
Interest expenditure	50.6	36.9		50.0		45.7	40.8	34.2
Reported net profit	242.1	4.7		1.2		79.4	4.0	8.6
Tax rate	51.1	29.1		NA		50.2	25.0	28.0

Company Description

DLF, incorporated in 1963, is a north India based real estate developer with presence across major markets in India. It is involved in development of various property types – residential, commercial and retail. More than 50% of its land bank is located in Gurgaon. It has ~30msf of leased rental assets located in key metros across India. The company is promoted by Mr. K. P. Singh who has four decades of experience in the Indian real estate industry.

Investment Theme

1. Earnings challenges ahead on account of lower pre-sales in past 3 years, weak pipeline of older projects and sluggish pace of new launches
2. Earnings dependent on sluggish Gurgaon market exposing it to single market risk
3. Expected improvement in balance sheet on account of infusion of sales proceeds by promoters from stake sale in rental assets and consequent capital raising to be off-set by significant equity dilution
4. Expensive earnings based valuations

Key Risks

1. Better valuations than expected for promoters' stake in DCCDL (rental) assets held through CCPS which is up for sale to strategic investors.
2. Sharp improvement in local macros climate.
3. Spike in new launches leading to pick-up in new sales and hence providing good visibility for surplus cash from operations.
4. Launch visibility of lucrative projects – Tulsiwadi, Chanakyapuri and Central Delhi projects (joint venture - JV with GIC).
5. Quick leasing of ongoing commercial projects at higher rentals and fast off-take of completed, but unsold inventory.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.5	7.1
Inflation (Avg)	4.9	4.5	3.8	4.5
Repo rate (exit rate)	6.8	6.3	6.0	6.0
USD/INR (Avg)	65.5	67.1	64.5	65.0
Company				
Selling Price increase (%)	5	5	5	5
Construction Cost Increase (%)	5	5	5	5

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	99,256	82,212	75,599	89,086
Direct costs	45,579	34,658	28,158	34,383
Employee costs	3,152	3,283	3,053	3,237
Other Expenses	10,553	9,938	8,944	9,481
Total operating expenses	59,284	47,879	40,156	47,101
EBITDA	39,972	34,333	35,443	41,985
Depreciation	7,659	5,725	5,988	6,080
EBIT	32,313	28,608	29,454	35,906
Add: Other income	6,714	7,193	6,473	6,538
Less: Interest Expense	26,798	29,798	30,821	30,445
Add: Exceptional items	1,967	(4,293)	-	-
Profit Before Tax	10,263	10,295	5,106	11,999
Less: Provision for Tax	5,642	2,293	1,277	3,360
Less: Minority Interest	(11)	(68)	800	1,000
Associate profit share	1,569	923	-	-
Reported Profit	3,062	7,148	3,030	7,639
Adjusted Profit	5,029	2,855	3,030	7,639
Shares o /s (mn)	1,784	1,784	1,784	1,784
Adjusted Basic EPS	2.8	1.6	1.7	4.3
Diluted shares o/s (mn)	1,784	1,784	1,784	1,784
Adjusted Diluted EPS	2.8	1.6	1.7	4.3
Adjusted Cash EPS	7.1	4.8	5.1	7.7
Dividend per share (DPS)	2.0	2.0	2.0	2.0
Dividend Payout Ratio(%)	116.5	49.9	117.8	46.7

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	59.7	58.2	53.1	52.9
Staff costs	3.2	4.0	4.0	3.6
S G & A expenses	10.6	12.1	11.8	10.6
Depreciation	7.7	7.0	7.9	6.8
Interest Expense	27.0	36.2	40.8	34.2
EBITDA margins	40.3	41.8	46.9	47.1
Net Profit margins	5.1	3.5	4.0	8.6

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	29.8	(17.2)	(8.0)	17.8
EBITDA	32.2	(14.1)	3.2	18.5
PBT	95.2	(50.9)	(14.9)	135.0
Adjusted Profit	0.8	(43.2)	6.1	152.1
EPS	0.7	(43.2)	6.1	152.1

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	3,567	3,568	3,568	3,568	
Reserves & Surplus	237,123	242,160	240,860	244,169	
Shareholders' funds	240,691	245,728	244,428	247,737	
Minority Interest	1,261	1,239	1,239	1,239	
Long term borrowings	252,638	292,022	297,863	303,820	
Def. Tax Liability (net)	(41,792)	(43,581)	(43,581)	(43,581)	
Sources of funds	452,798	495,408	499,949	509,215	
Gross Block	228,011	229,584	230,326	233,837	
Net Block	222,317	218,402	213,155	210,587	
Capital work in progress	17,791	19,418	23,786	25,774	
Total Fixed Assets	240,107	237,820	236,941	236,361	
Goodwill on consolidation	10,179	10,110	10,110	10,110	
Non current investments	19,292	11,575	11,500	11,500	
Cash and Equivalents	34,554	41,509	33,658	39,703	
Inventories	168,342	199,491	215,275	226,464	
Trade receivables	34,868	37,193	35,531	31,180	
Loans & Advances	14,415	9,997	10,197	9,993	
Other Current Assets	53,744	51,706	52,000	52,500	
Total current assets	271,368	298,386	313,003	320,137	
Current liabilities	117,083	102,745	104,015	105,349	
Provisions	5,620	1,247	1,247	1,247	
Total Current Liab	122,703	103,992	105,262	108,596	
Net Curr Assets-ex cash	148,665	194,395	207,741	211,541	
Uses of funds	452,798	495,408	499,949	509,215	
BVPS (INR)	134.9	137.7	137.0	138.9	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	3,062	7,148	3,030	7,639	
Add: Depreciation	7,659	5,725	5,988	6,080	
Interest (Net of Tax)	14,434	18,417	23,116	21,616	
Less: Changes in WC	(85,293)	45,729	13,346	3,801	
Operating cash flow	96,014	(32,856)	(4,328)	9,918	
Less: Capex	9,572	1,573	741	3,512	
Free Cash Flow	100,876	(16,012)	18,047	28,022	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
DLF	6,087	130.1	51.6	1.6	1.6	1.2	3.1
Brigade Enterprises	594	22.6	19.1	1.6	1.5	8.4	8.3
Godrej Properties	2,581	72.0	40.9	7.8	6.8	11.2	17.7
Oberoi Realty	2,446	36.3	12.9	2.6	2.2	7.4	18.4
Sobha Limited	806	24.7	21.7	1.9	1.7	7.7	8.2
Sunteck Realty Limited	912	26.9	18.5	2.2	2.0	9.9	11.4
Median	-	31.6	20.4	2.0	1.9	8.1	9.9
AVERAGE	-	52.1	27.5	3.0	2.6	7.6	11.2

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Investing cash flow	(15,413)	4,349	(5,034)	(5,500)	
Financing cash flow	(80,736)	(3,922)	(4,330)	(4,330)	
Net cash Flow	(134)	(32,430)	(13,692)	88	
Capex	9,572	1,573	741	3,512	
Dividend paid	4,329	4,330	4,330	4,330	
Share issue/(buyback)	(31,731)	2,219	-	-	

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
EOP(ROE) (%)	1.2	2.9	1.2	3.1
ROAE (%)	2.0	1.2	1.2	3.1
ROACE (%)	10.3	8.4	8.4	9.5
Current Ratio	2.5	3.3	3.3	3.3
Gross Debt/EBITDA	6.3	8.5	8.4	7.2
Gross Debt/Equity	105.0	118.8	121.9	122.6
Net Debt/Equity	90.6	101.9	108.1	106.6

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	0.2	0.2	0.2	0.2
Fixed Asset Turnover	0.5	0.4	0.4	0.4
Equity Turnover	0.4	0.3	0.3	0.4

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	2.8	1.6	1.7	4.3
Y-o-Y growth (%)	0.8	(43.2)	6.1	152.1
Adjusted Cash EPS (INR)	7.1	4.8	5.1	7.7
Diluted P/E (x)	78.4	138.1	130.1	51.6
P/B (x)	1.6	1.6	1.6	1.6
Dividend Yield (%)	0.9	0.9	0.9	0.9

Additional Data

Directors Data

Dr. K.P. Singh	Chairman	Mr. Rajiv Singh	Vice Chairman
Dr. D.V. Kapur	Independent Director	Mr. K.N. Memani	Independent Director
Mr. B. Bhushan	Independent Director	Mr. Mohit Gujral	CEO & Whole-time Director
Mr. Rajeev Talwar	CEO & Whole-time Director	Ms. Pia Singh	Independent Director
Mr. G.S. Talwar	Independent Director	Mr. Pramod Bhasin	Independent Director
Mr. Rajiv Krishan Luthra	Independent Director	Mr. Ved Kumar Jain	Independent Director
Lt. Gen. Aditya Singh (Retd.)	Independent Director	Mr. A. S. Minocha	Independent Director

Auditors - M/s. Walker, Chandiok & Co

**as per latest annual report*

Holding – Top 10

	Perc. Holding		Perc. Holding
Oppenheimer Funds	5.38	Kohinoor Real Estate	5.34
GIC Private Ltd	4.65	Vanguard Group	0.94
Voya Investments	0.59	Dimensional Fund Advisors	0.58
Edelweiss Capital	0.26	Kotak Mahindra	0.19
Reliance Capital	0.17	HDFC Asset Management	0.17

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Brigade Enterprises	BUY	SO	M	DLF	BUY	SP	H
Godrej Properties	HOLD	SP	L	Oberoi Realty	BUY	SP	L
Sobha Limited	BUY	SO	M	Sunteck Realty Limited	BUY	SO	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Real Estate

Brigade Enterprises, DLF, Godrej Properties, Oberoi Realty, Sobha Limited, Sunteck Realty Limited

Recent Research

Date	Company	Title	Price (INR)	Recos
20-Feb-18	Sunteck Realty	Growth horizons expanding; <i>Result Update</i>	401	Buy
12-Feb-18	Sobha	Maintains strong growth trajectory; <i>Result Update</i>	562	Buy
12-Feb-18	Brigade Enterprises	On steady growth path; <i>Result Update</i>	295	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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