

Sobha Developers

Rs 550-640

22nd Nov 2006

Long-term story

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Issue Details	
Offer Price	Rs 550-640
Face Value	10.0
Shares Offered (in lakhs)	88.9
Type	Fresh Issue
Promoter	Mr P N C Menon
Listing (Stock Exchange)	BSE & NSE
Offer Open Date	November 23, 2006
Offer Close Date	November 29, 2006
Website: www.sobhadevelopers.com	

Scrip Estimates (at Rs 640)	
Market Cap (Rs crores)	4,665.6
EPS - FY07e	14.8
P/E(x) - FY07e (fully diluted)	43.2
Market Cap/Sales (x) FY07e	4.5

	Pre Offer	Post Offer
Promoters	99.1	87.0
Employees	0.0	1.2
Public	-	11.0
Others	0.9	0.8

Financials (Rs crores)	FY05	FY06	H1FY07
Sales	453.1	596.6	517.6
EBITDA	53.6	109.7	84.8
EBIT	46.2	98.5	73.9
Other Income	12.1	31.8	15.2
PBT	47.3	108.4	61.2
PAT	33.9	89.2	23.3
Equity	21.1	21.1	63.4
*EPS (Rs)	4.6	12.2	7.4

*on post-diluted equity of Rs 72.9 crores

Investors should read the risk factors and more detailed information in the Prospectus and the Application Form before investing in the issue.

 Website: www.way2wealth.com

Sobha Developers is one of the leading real estate development and construction companies in India. The Company has land reserves of 2,747.06 acres and land arrangements of 3,373.28 acres. It is currently developing 28 residential and commercial projects, spanning over 10 million sq ft. Besides this, the Company is also developing 23 projects on a contract basis amounting to Rs 529 crores, the majority being for Infosys.

Extensive land bank: The Company has huge land reserves of 2,747.06 acres, which have been valued by Cushman & Wakefield at Rs 7,035.6-7,776.2 crores. After deducting the developer's margin, the value stands at Rs 3,971.7-4,389.8 crores. The Company has also entered into land arrangements for 3,373.28 acres, where certain third party entities have agreed to procure land on the Company's behalf. This land has been valued at Rs 4,347.8-4,805.4 crores, and at Rs 2,306-2,548.7 crores, post developer's margin.

Unique backward-integration model: The Company has a unique backward integration model, where it has the key competencies and in-house resources to deliver a project, from its conceptualisation to completion. The Company has an architectural and design studio, concrete block-making plant, metal and glazing factory, interiors and woodworking factory, mechanical, electrical & plumbing division and a project management team. This facility ensures that products and services required for development and construction adhere to quality standards and are delivered in a timely manner, besides having a better control over cost over-runs. This also reduces the Company's dependency on third party suppliers for key products and services.

Diversifying portfolio of projects: The Company intends to diversify its portfolio, by developing hotels, integrated townships, malls, multiplexes and shopping complexes. As a step towards this, the Company has entered into an MoU with Reliance Energy, for setting up an SPV in response to an Expression of Interest (EoI) invited by Andhra Pradesh Industrial Infrastructure Corporation, for the development of a business district and trade towers in Hyderabad. The Company has also entered into an MoU with Tree Hill Pvt Ltd, for carrying out real estate activities in Kerala. Thus, the Company would be able to provide its products across the real estate value chain.

Favourable industry scenario: Indian realty is currently a hotcake, with everyone wanting to grab a piece of it. The demand for housing would continue to outstrip supply, fuelled by the growing population, increasing urbanisation, rise in disposable income, rising penetration of housing finance and favourable tax structures. In middle and higher income housing groups, the housing spend is estimated to increase from Rs 1,718 billion in FY05 to Rs 4,034 billion in FY10. Similarly, in commercial real estate, IT/ITES sector is driving growth. Cushman & Wakefield estimates that the cumulative demand for office space between FY05 and FY08 would be in excess of 85 million sq ft.

Long-term story: Sobha Developers has got the right ingredients of a long-term story, with a well-diversified portfolio, integrated operations, substantial land reserves and foray into newer locations. At the upper price band of Rs 640, the stock is priced at 43.2x its FY07e annualised post-diluted EPS of Rs 14.8 and 37.2x at the lower price band of Rs 550. Considering the prevailing real estate boom, we strongly recommend investors to SUBSCRIBE to the issue, with a long-term perspective.

Company Background

The Company was incorporated as *Sobha Developers Pvt Ltd* in Aug95. Subsequently, the Company became a limited company after the fresh certificate of incorporation was issued in May06. The Company is one of the leading real estate development and construction companies in India that focus on residential and contractual projects. As of Sep06, the Company has land reserves of 2,747.06 acres and land arrangements of 3,373.28 acres. The Company has also developed and constructed 21 residential projects in Bangalore and 75 contractual projects across 8 states of India. It is a preferred developer for Infosys, as it has executed 64 projects for the tech major, representing 85.3% of the total contractual projects.

The Company is backward integrated, as it has all the competencies and resources to deliver a project, from conceptualisation to completion. The Company has an architectural and design studio, concrete block-making plant, metal and glazing factory, interiors and woodworking factory, mechanical, electrical & plumbing division and a project management team. These facilities ensure that the products and services required for development and construction adhere to the quality standards and are delivered in a timely manner. This also reduces the Company's dependency on third party suppliers, for key products and services required in the process of development and construction of projects.

Objects of the Issue

The objects of the Issue are to finance land acquisition and also the construction & development costs for some of the Company's existing and proposed residential projects, to repay certain loans of the Company and to fund the expenditures for general corporate purposes.

Year-wise break-up of fund requirement

Particulars (Rs crores)	Estimated amount	Utilisation of proceeds as on			
		FY07	FY08	FY09	FY10
Land acquisition	234.3	234.3	-	-	-
Development & construction cost for existing & forthcoming projects	142.5	43.4	53.4	44.6	1.1
Repayment of loans	132.2	132.2	-	-	-
General corporate purposes	*	*	*	*	*
Total	*	*	*	*	*

Business Model:

Residential & commercial projects: Till date, the Company has developed 21 projects, aggregating 1,552 apartments and covering 2.98 million sq ft of super built area. These projects are located in Bangalore. The Company is also developing 28 projects, which are under various stages of implementation.

Besides this, the Company has also developed two commercial projects, on turnkey basis, in Bangalore, with a super built-up area of 0.11 million sq ft.

	No of projects	Super built up area (million sq ft)	No of apartments
Projects developed	21	2.98	1,552
Projects under development	15	4.97	2,682
Forthcoming projects	13	5.17	3,055
Total	49	13.12	7,289

Contractual projects: In contractual projects, the Company undertakes to perform construction for third parties on pre-agreed terms and conditions. The scope of work includes designing, electrical works, plumbing works, metal and glazing works, interiors and construction. The Company also undertakes finishing and interior related work on structures that have already been built. The Company's portfolio of projects includes convention centres, multiplexes, restaurants, hostel facilities and software development blocks.

Till date, the Company has constructed 75 projects in India, on a contractual basis, in eight states, covering approximately 8.42 million sq ft of super built-up area, with total contract value of Rs 767.3 crores. The Company's major client is Infosys, for which it has executed 64 projects, representing 85.33% of the total projects. In FY06, Infosys accounted for 82.95% of the total contractual revenue.

The Company is currently executing 23 projects for various corporate houses and other entities like schools and hospitals. The total contract value is Rs 529.2 crores.

Investment Argument

- Extensive land bank:** The Company has huge land reserves of 2,747.06 acres, located in Bangalore, Mysore, Pune, Chennai, Cochin, Thrissur and Coimbatore. Cushman & Wakefield India Pvt Ltd, an international property consultant, has valued the land reserves between Rs 7,035.6-7,776.2 crores. After deducting the developer's margin, the value stands at Rs 3,971.7-4,389.8 crores. The Company has also entered into land arrangements for 3,373.28 acres, under which certain third party entities have agreed to procure lands located in and around Cochin, Pune and Chennai on the Company's behalf. Land arrangements have been valued at Rs 4,347.8-4,805.4 crores, and at Rs 2,306-2,548.7 crores, post developer's margin.

YE March 31 (Rs crores)	Acres
Land reserves	2,747.06
<i>(A) No present development</i>	2,692.79
(i) Title in the company's name	132.29
(ii) Executed contractual & joint development agreements	1,575.53
(iii) Currently owned by 3rd party individuals or corporate entities	984.97
<i>(B) Under development</i>	54.27
(i) Title in the company's name	38.92
(ii) Executed joint development agreements	15.35
Land arrangements	3,373.28
Total	6,120.34

- Unique Backward Integration model:** In an industry where outsourcing is the norm, the Company has a unique backward integration model, where it has the key competencies and in-house resources to deliver a project, from its conceptualisation to its completion.

Division	Nature of work
Interiors & wood working	Engaged in manufacturing doors, windows, wooden floorings, ceilings, panelling, pillars and staircases
Glazing & metal	Engaged in metal fabrication such as aluminium windows and doors, structural and architectural glazing
Building materials	Manufactures hollow and solid concrete blocks, medium and heavy duty concrete pavers, water drainage products
Mechanical, Electrical and Plumbing	Responsible for mechanical, plumbing and air-conditioning works. Also responsible for advising fire, safety and public health.
Architecture	Designs all in-house residential and contractual projects, and also assists in designing the contractual projects, where required
Project implementation	Monitors the complete development life-cycle of a project to ensure optimal utilisation of resources

These facilities ensure that products and services required for development and construction adhere to quality standards and are delivered in a timely manner, besides having a better control over cost over-runs. This also reduces the Company's dependency on third party suppliers, for key products and services, required in the process of development and construction of projects.

- Diversifying the portfolio of projects:** The Company, which is basically into construction of residential and commercial projects, now intends to diversify its portfolio, by developing hotels, integrated townships, malls, multiplexes and shopping complexes. Thus, the Company intends to capitalise on the development and construction opportunities generated by various sectors. As a step towards this, the Company has entered into an MoU with Reliance Energy, for setting up an SPV in response to an EoI invited by Andhra Pradesh Industrial Infrastructure Corporation, for the development of a business district and trade towers in Hyderabad. The Company has also entered into an MoU with Tree Hill Pvt Ltd, for carrying out real estate activities in Kerala. Thus, the Company would be able to provide products across the real estate value chain.
- Favourable industry scenario:** Indian real estate is currently a hotcake, and everyone wants to grab a piece of it. Demand for housing would continue to outstrip supply, fuelled by the growing population, increasing urbanisation, rise in disposable income, rising penetration of housing finance and favourable tax structures. In middle and higher income housing groups, the housing spend is estimated to increase, from Rs 1,718 billion in FY05 to Rs 4,034 billion in FY10. Similarly, in commercial real estate, the IT/ITES sector is driving growth. Cushman & Wakefield estimates that the cumulative demand for office space between FY05 and FY08 would be in excess of 85 million sq ft.

Concerns

- Since the past year, land prices have skyrocketed and touched dizzying heights. In the event of re-rating of land prices, the land bank of the Company would be significantly affected.
- The Company's residential project portfolio is concentrated in Bangalore. In the event of a regional slowdown in the construction activity in Bangalore, the financial conditions and the result of operations could be adversely affected. However, to mitigate this risk, the Company is now expanding its operations to other cities like Mysore, Pune, Kochi, NCR and Mumbai.
- For FY04, FY05 and FY06, the Company derived 55%, 61% and 28% of the revenues, respectively, from Infosys. Though Infosys has big expansion plans, excess dependence raises concerns, considering the fact that most of its forthcoming contractual projects are also from Infosys. However, association with Infosys would also act as a key catalyst in expanding its contractual clientele.

Financials

YE March 31 (Rs crores)	FY04	FY05	FY06	H1FY07
Net Sales	195.1	453.1	596.6	517.6
EBITDA	14.5	53.6	109.7	84.8
PBT	16.5	47.3	108.4	61.2
PAT	8.9	33.9	89.2	54.0
Equity Paid Up	21.1	21.1	21.1	63.4
Net worth	29.4	64.8	136.8	190.8
Capital employed	86.0	289.9	562.2	861.0
Gross Block	25.7	55.7	125.2	184.9
*EPS (Rs)	1.2	4.6	12.2	7.4
*CEPS (Rs)	1.6	5.8	13.8	8.9
Dividend (%)	35.0	30.0	68.5	-
Payout (%)	94.4	21.2	18.5	-
Debt: Equity (times)	1.9	3.4	3.1	3.5
ROCE (%)	24.8	20.1	23.2	#20.8
RONW (%)	30.2	52.2	65.2	#56.6
EBITDM (%)	7.4	11.8	18.4	16.4

* on post-diluted equity of Rs 72.9 crore;

#annualised

Investment Argument

Sobha Developers has a vast land bank, which would place the Company in good stead in developing and constructing residential and commercial projects. The Company is currently developing ~10 million sq ft of residential projects, which would be executed over a period of 1.5-2 years. These projects would generate revenues of ~Rs 2,000 crores during the said period. Besides this, the Company also has a contractual project order book amounting to Rs 529 crores.

Going forward, the Company expects residential contribution to be at 75%, with the rest from contractual income. In a bid to diversify its portfolio, the Company is actively pursuing presence in hotels, malls, multiplexes, etc. Thus, the Company would be able to capitalise on the emerging opportunities generated by various sectors. In addition to this, the Company's unique backward integration model would result in margin expansion, with no dependence on suppliers.

At the upper price band of Rs 640, the stock is priced at 43.2x its FY07e annualised post-diluted EPS of Rs 14.8 and 37.2x at the lower price band of Rs 550. Considering the prevailing real estate boom, we strongly recommend investors to SUBSCRIBE to the issue, with a long-term perspective.

Peer comparison

Particulars (in Rs crores) Trailing 12 months	Sobha Developers	Ansal Housing	DS Kulkarni	Mahindra Gesco	Unitech
Sales	862.5	164.9	219.7	153.3	1,032.5
Operating profit	162.5	51.5	36.9	26.0	290.0
EBITDA margin (%)	18.8	31.2	16.8	17.0	28.1
PAT	120.0	30.8	28.4	12.6	223.3
Equity	72.9	14.9	22.0	37.0	162.3
Face Value (Rs)	10.0	10.0	10.0	10.0	2.0
Market cap	4,665.6	513.4	653.2	3,509.3	21,319.3
Market cap/sales (x)	5.4	3.1	3.0	22.9	20.7
Market Price (Rs)	640.0	343.9	296.9	947.7	262.7
EPS (Rs)	16.5	20.7	12.9	3.4	2.8
PE (x)	38.9	16.7	23.0	279.2	95.5

WAY2WEALTH Research

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