

Sobha ----- Downgrade to NEUTRAL

Fairly valued, given concerns on liquidity

EPS: ▼ TP: ▼

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- In a deteriorating macro environment, real estate developers are seeing slowing demand for both residential and commercial projects – which, coupled with difficulties in fund raising from other sources, will likely lead to delays in launches in our view.
- We believe that Sobha is likely to be prone to delays in launches because of a lack of liquidity, given the company's high debt/equity ratio of 1.73x and ambitious plans for scaling up its business, for which large capital will be required.
- We revise our estimates for Sobha to account for slower launches in FY3/09 and FY3/10. We also factor in a higher WACC and increase our cap rate assumptions for lease projects in order to reflect the changing macro environment. Our NAV for Sobha stands reduced to Rs688 from Rs1068.
- Our new target price of Rs275.3 for Sobha is based on a 60% discount to our FY09E NAV and implies an upside of ~7% from current levels – although we believe the company should realise its NAV in the long run. Downgrade to NEUTRAL.

Bbg/RIC	SOBHA IN / SOBH.BO		Price (14 Jul 08, Rs)	257.10	
Rating (prev. rating)	N (O) [V]	TP (Rs) (prev. TP)		275 (801)	
Shares outstanding (mn)	72.90	Est. pot. % chg. to TP		7	
Daily trad vol-6m avg (mn)	0.3	52-wk range (Rs)	1050.00 - 243.40		
Daily trad val-6m avg (US\$ mn)	6.5	Mkt cap (Rs/US\$ mn)	18,743.1/ 468.2		
Free float (%)	13.0	Performance	1M 3M 12M		
Major shareholders	Promoter group	Absolute	(36.9) (56.4) (73.1)		
		Relative	(87%) (28.9) (48.8) (70.2)		
NAV (Rs)	688.1	Prem./disc to NAV (%)		(62.6)	
3 yr EPS CAGR (%)	20.1	Dividend yield (%)		2.5	
Year	3/06A	3/07A	3/08E	3/09E	3/10E
EBITDA (Rs mn)	1,396	2,576	3,737	4,367	5,284
Net profit (Rs mn)	885	1,615	2,281	2,481	2,800
EPS (Rs)	14.0	22.2	31.3	34.0	38.4
- Change from prev. EPS (%)	n.a.	n.a.	-3	-30	-41
- Consensus EPS (Rs)	n.a.	n.a.	32.7	39.9	54.9
EPS growth (%)	161.4	58.8	41.2	8.8	12.9
P/E (x)	18.4	11.6	8.2	7.6	6.7
DPS (Rs)	2.28	5.50	6.50	7.00	7.50
EV/EBITDA (x)	16.2	9.1	9.7	7.6	6.6
ROE (%)	96.1	34.2	25.3	22.5	21.4
Net debt/equity (%)	300	57	173	122	113

Note 1: Sobha Developers was incorporated in 1995 by Mr PNC Menon, an entrepreneur with three decades of experience in real estate and construction. Sobha completed its first residential project in Bangalore in 1999 and its first contractual project in 2000.

Slower demand, liquidity constraints to impact launches

As a result of the rapidly deteriorating macro environment, demand for real estate has witnessed a slow down in recent times - demand for residential projects has dried up due to rising interest rates, lower wage hikes and high inflation, whilst commercial projects are also seeing slower off-take given the uncertain business environment.

The problem is compounded by liquidity worries – developers are becoming hard pressed to fund ongoing developments: debt is available only at high cost, volatility in equity markets is making fund raising difficult and private equity transactions are few and far between. We see the above coupled with lower cash generation from existing projects leading to a slow down in new launches in FY09/10.

We believe that Sobha is likely to be prone to delays in launches, given the company's high gearing and ambitious plans for scaling up its business, with ongoing projects spanning 10.3mn sq ft and planned developments aggregating 24.5mn sq ft of developable area. The company currently has a net debt/equity ratio of 1.73x, and may find it difficult to raise funding without paying a high rate of interest.

Figure 1: Revised schedule of launches for Sobha

Launches (mn sq ft)	FY3/09E			FY3/10E		
	Old	New	% change	Old	New	% change
Plots	1.7	2.2	28.0	3.2	3.8	19.7
Villas	1.7	0.5	(69.5)	3.2	1.7	(46.1)
Residential	5.5	4.5	(18.1)	9.2	6.4	(29.6)
Commercial	1.4	0.5	(60.7)	2.7	1.4	(50.5)
Retail	0.9	0.2	(77.9)	1.4	0.6	(54.7)
Total	11.2	7.9	(28.9)	19.6	13.9	(29.0)

Source: Company data, Credit Suisse estimates.

We revise our NAV estimates for Sobha to account for slower launches over the next 2 years. We have also increased our WACC estimates and cap rate assumptions to account for a worsening macro environment. We now factor in a WACC of 15.35% for Sobha (13.8% earlier), on a higher risk free rate assumption of 9.5% (8.2% earlier), and assume higher cap rates of 10.5% and 12% (9% and 10% earlier) for commercial and retail projects respectively. Accordingly, our FY09E NAV for Sobha stands reduced to Rs688 (previously Rs1068)

Figure 2: FY09E NAV valuation summary

	mn sq ft	Value (Rs bn)	Rs/ share
Residential development	185.4	55.5	761.1
Commercial & Retail sale	15.9	7.9	108.7
Commercial lease	28.4	3.9	53.2
Gross asset value		67.3	923.1
Less: Land cost to be paid		(3.6)	(48.7)
Less: Net Debt		(13.6)	(186.2)
FY09 Net Asset Value (NAV)		50.2	688.1
Premium/ (Discount) to NAV		(30.1)	(412.9)
Net Firm value		20.1	275.3

Source: Company data, Credit Suisse estimates.

As a result of slower launches, our EPS estimates for Sobha in FY3/09 and FY3/10 also stand revised downwards by 30% and 41% respectively. Our new target price of Rs275.3 for Sobha is based on a 60% discount to our FY09E NAV and implies an upside of ~7% from current levels. We downgrade our recommendation on the stock to NEUTRAL from OUTPERFORM

Figure 3: Summary of changes to our estimates

Rs/share	FY3/09E			FY3/10E		
	Old	New	% change	Old	New	% change
Net revenues	17.3	15.7	(9.4)	20.5	18.6	(9.5)
EBITDA	5.8	4.4	(25.2)	7.9	5.3	(33.4)
EBITDA Margin (%)	33.8	27.9		38.7	28.5	
PAT	3.6	2.5	(30.4)	4.8	2.8	(41.3)
EPS (Rs)	48.9	34.0	(30.4)	65.5	38.4	(41.3)

Source: Company data, Credit Suisse estimates.

Companies Mentioned (Price as of 11 Jul 08)

Sobha Developers Ltd (SOBH.BO, Rs257.10, NEUTRAL [V], TP Rs275.30)

Disclosure Appendix

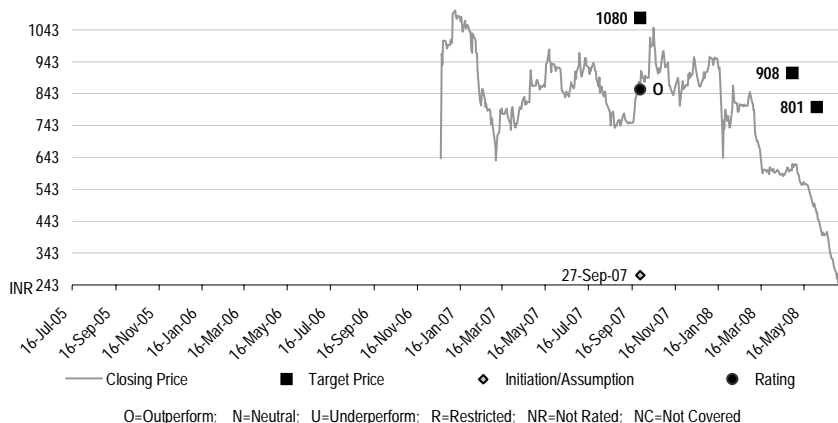
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3-Year Price, Target Price and Rating Change History Chart for SOBH.BO

SOBH.BO	Closing Price	Target Price	Initiation/
Date	(INR)	(INR)	Rating Assumption
27-Sep-07	856.15	1080	O X
29-Apr-08	622.3	908	
3-Jun-08	470.75	801	



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Price Target: (12 months) for (SOBH.BO)

Method: Our price target of Rs275.3 for Sobha Developers is based on a 60% discount to the 12-month forward NAV of Rs688. The 60% discount to NAV is justified given a) 25% of land cost is unpaid; b) relatively small scale, with concentration of landbank in Bangalore; and c) lack of experience in developing own commercial/retail projects.

Risks: The key risks to our Rs275.3 target price for Sobha Developers are: 1) any slowdown in Bangalore market, which accounts for about 40% of Sobha's landbank; 2) strategic derisking by key clients; and 3) overall slowdown in economic growth in India in general and IT/ITES sector in particular.

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