

Real Estate

Earnings revisions

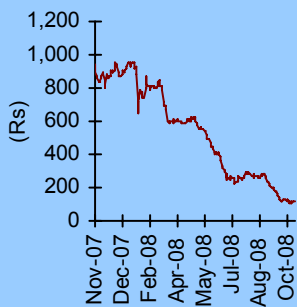
(%)	FY09E	FY10E	FY11E
Sales	↓ 49.6	↓ 61.8	↓ 56.3
EBITDA	↓ 38.2	↓ 56.5	↓ 51.7
EPS	↓ 50.9	↓ 71.1	↓ 67.7

Shareholding pattern

	Mar '08	Jun '08	Sep '08
Promoters	87.0	86.9	86.9
Institutional investors			
MFs and UTI	9.4	7.9	6.4
Banks, FIs	1.3	1.6	1.1
FIs	0.0	0.0	0.0
Others	8.1	6.0	4.9
	3.6	5.2	6.7

Source: CMIE

Price chart



Gaurav Pathak

gaurav_pathak@isecltd.com
+91 22 6637 7339

Shaleen Silori

shaleen_silori@isecltd.com
+91 22 6637 7188

INDIA

Sobha Developers

BUY

Maintained

Rs114

In a quagmire

Reason for report: NAV revision & Q2FY09 results review

Sobha Developers' Q2FY09 results were in line with expectations with revenues and PAT dipping 10% YoY & 13% YoY to Rs2.9bn & Rs490mn respectively. The company's Q2FY09 revenue contribution from realty and contractual segment (including manufacturing income) was at Rs1.85bn (63%) and Rs1.1bn (37%). Sobha is facing headwinds in the form of downturn in realty and strained balance sheet. The debt level has increased 3x to Rs19bn in one year, and new sales and project launches have slowed down. We lower FY09E NAV estimate to Rs282/share (target price at Rs169/share), assuming 25% drop in selling prices and increased timelines by 8-10 years (reducing development pipeline 55-65%). We also lower FY09E & FY10E earnings estimates 51% and 71% respectively. Sobha's balance sheet is stretched and any respite through the proposed rights issue of Rs3.5bn will be temporary unless housing demand picks up. We downgrade Sobha's NAV owing to sluggish sales and stretched balance sheet. However, there is limited downside from the current levels given FY08 BV/share of Rs136 and that land bank's value at cost is Rs110/share; reiterate BUY.

- ▶ **Stretched balance sheet.** In the past one year, Sobha's debt surged 3x to Rs19bn and debt-to-equity jumped from 0.7x to 1.8x. The company continues to face liquidity crunch as sales have slowed down, though the Rs3.5bn rights issue could provide temporary respite. However, unless housing demand picks up (dependent on sharp drop in selling price and home loan rates), we do not expect liquidity to improve. Sobha will face high interest cost burden, which will significantly erode earnings and deteriorate cash-flow.
- ▶ **Valuation assumptions.** To account for the above mentioned changes, we have reduced selling price assumption 25% for Sobha's projects and increased cost of construction 12%. We have also streamlined and extended project timelines by 8-10 years to account for delays in project launches and execution (annual development pipeline reduced 55-65%). We have increased cost of equity & debt assumptions 300bps & 200bps respectively to account for increased liquidity crunch and risk attached to high debt/equity.
- ▶ **Outlook.** At the current market price of Rs114/share, Sobha is trading at FY09E, FY10E & FY11E P/E of 4.9x, 5.8x and 5x with EPS estimates of Rs23.5, Rs19.8 & Rs22.2 respectively. We expect earnings CAGR of (10%) in FY08-11E. BUY.

Market Cap	Rs8.3bn/US\$170mn
Reuters/Bloomberg	SOBH.BO/SOBHA IN
Shares Outstanding (mn)	73
52-week Range (Rs)	958/107
Free Float (%)	13.1
FII (%)	4.9
Daily Volume (US\$'000)	1,200
Absolute Return 3m (%)	(57.4)
Absolute Return 12m (%)	(87.9)
Sensex Return 3m (%)	(29.1)
Sensex Return 12m (%)	(47.2)

Year to March	FY08	FY09E	FY10E	FY11E
Revenue (Rs mn)	14,226	14,407	15,314	18,964
Net Income (Rs mn)	2,283	1,712	1,444	1,653
EPS (Rs)	31.3	23.5	19.8	22.7
% Chg YoY	41.4	(25.0)	(15.7)	14.5
P/E (x)	3.6	4.9	5.8	5.0
CEPS (Rs)	36.1	25.5	22.3	25.6
EV/E (x)	7.3	7.3	8.3	8.0
Dividend Yield	5.7	3.5	3.5	3.5
RoCE (%)	13.1	9.8	8.2	8.1
RoE (%)	24.7	16.2	12.2	12.7

Revenue break-up

In Q2FY09, Sobha's revenue contribution from realty and contractual segments (including manufacturing income) was at Rs1.85bn (63%) and Rs1.1bn (37%). Going forward, we expect realty to contribute ~80% to Sobha's revenues. In Q2FY09, the company booked revenues from the sale of 514,000sqft versus 535,000sqft in Q1FY09.

Table 1: Q2FY09 results review

(Rs mn, year ending March 31)

	Q2FY09	Q2FY08	chg (YoY)	Q1FY09	chg (QoQ)
Gross sales	2,934	3,254	(9.8)	3,468	(15.4)
Excise duty	-	-		-	
Net Sales	2,934	3,254	(9.8)	3,468	(15.4)
Other operating income	68	-			
Total Operating income	3,002	3,254	(7.8)	3,468	(13.4)
Raw Materials	1,449	1,786	(18.9)	1,604	(9.7)
Personnel Cost	188	247	(24.0)	331	(43.2)
Research & Development					
Other Expenses	429	396	8.4	517	
Total Expenses	2,066	2,429	(14.9)	2,452	(15.7)
EBITDA	936	825	13.4	1,016	(7.9)
Interest (Net)	285	133	114.7	267	6.7
Depreciation	89	88	1.2	89	-
Other Income	19	76	(75.0)	20	(5.0)
Recurring pre-tax income	581	680	(14.6)	680	(14.6)
Taxation	91	118	(23.2)	175	(48.0)
Recurring Net Income	490	562	(12.8)	505	(3.0)
Extraordinary item	-	-		-	
Reported Net income	490	562	(12.8)	505	(3.0)

Source: Company data, I-Sec Research

Sobha is low on cash and the liquidity crunch is further denting its ability to fund ongoing projects and expansion plans. Anticipation of price correction and high interest rate has kept housing demand sluggish. This has led to significant reduction in transaction volumes. In such a scenario, we believe only significant correction in property prices and home loan rates can propel demand.

Sobha is planning a rights issue worth Rs3.5bn by Q4FY09, which will bring its D/E below 1.5x. The company will use the proceeds for general corporate purposes, including working capital and paying off outstanding land payment.

Valuations

Sobha's fair value estimate, based on NAV, is at Rs20.6bn or Rs282/share. We downgrade target price to Rs169/share and expect the stock to trade at 40% discount to its NAV.

Given the softness in the property market, we have assumed 20-27% drop in residential selling prices from the current selling price to calculate NAV. We have increased cost of equity and debt assumptions 300bps and 200bps respectively. Ramp-up plans will be difficult to execute and therefore, we have assumed significant launch delays and extended development schedule by 8-10 years given lower absorption. We have also assumed 55-65% reduction in development pipeline each year.

Table 2: Valuations

(Rs mn)

	Revised	Earlier	Remarks
NAV	37,394	72,953	Reduced SP 20-25%, increased cost 12% and extended timeline by 8-12 Years
Net Debt	17,544	(6,171)	
Land payment	4,903		
Terminal value	1,456	6,574	Assumed development of 3mn sqft YoY with PAT realisations of Rs300/sqft
EPC Value	4,191	10,411	Reduced EBITDA 19% and EV/EBITDA multiple to 4x from 8x
NPV	20,593	96,520	
NPV/share (Rs/share)	282		
Target price (Rs/share)	169		
Valuation @land at cost (Rs/share)	110		

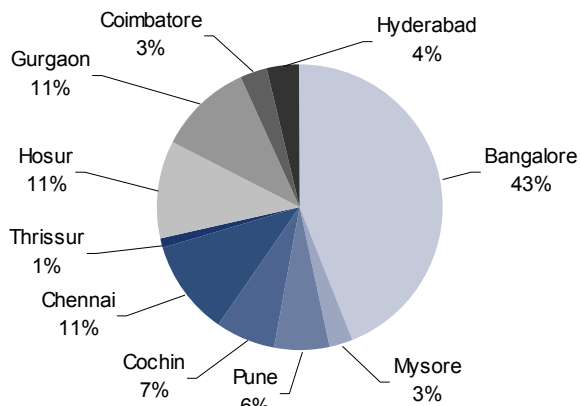
Source: Company data, I-Sec Research

Table 3: Regional break-up

Region	Saleable Area (in mn sqft)	NAV (Rs mn)
Bangalore	86	15,699
Mysore	3	1,017
Pune	9	2,174
Cochin	28	2,402
Chennai	29	3,849
Thrissur	1	496
Hosur	39	3,929
Gurgaon	8	3,935
Coimbatore	4	1,057
Hyderabad	4	1,286

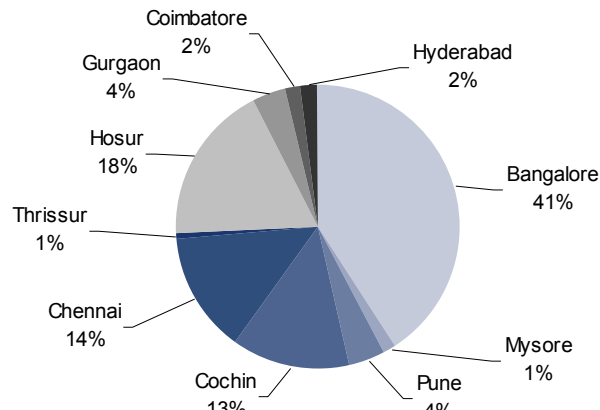
Source: Company data, I-Sec Research

Chart 1: NAV – Geographical



Source: Company data, I-Sec Research

Chart 2: Land bank – Regional break-up



Land bank & project pipeline

Sobha's total land bank is at ~3,327 acres (~220mn sqft saleable area) spread across 10 cities and currently, 12mn sqft is under construction. The company has paid Rs20.9bn as land cost with Rs2.9bn (renegotiating prices) outstanding, to be repaid in the next 2-3 years. The company plans to pay off ~Rs1bn towards land payment in FY09E. Sobha is expected to launch projects with a development pipeline of 13mn sqft (~80% residential) in the next three years. The company is expanding to new locations such as Coimbatore, Pune, Chennai and Mysore to increase volumes.

Table 4: Project development pipeline

Cities	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	Total
Bangalore	2.2	2.2	2.2	2.2	2.4	2.4	2.4	2.4	2.4	20.7
Mysore	0.4	0.4	0.4	0.4	0.6	0.6	0.6	0.0	0.0	3.4
Pune	0.4	0.4	0.4	0.4	0.8	1.2	1.2	1.2	1.2	7.1
Cochin	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.6	0.8	1.9
Chennai	0.1	0.2	0.3	0.6	0.6	0.6	0.6	0.6	1.4	5.0
Hosur	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.8	1.2	3.1
Trissur	0.1	0.2	0.3	0.4	0.4	0.0	0.0	0.0	0.0	1.5
Coimbatore	0.0	0.0	0.0	0.9	0.9	0.9	0.9	0.0	0.0	3.6
Delhi	0.7	0.7	0.7	0.7	1.0	1.0	1.0	1.0	0.7	7.2
Hyderabad	0.0	0.0	0.8	0.8	0.8	0.8	0.8	0.0	0.0	4.2
Total	3.9	4.1	5.2	6.4	7.9	8.1	8.1	6.5	7.7	57.8

Source: Company data, I-Sec Research

Financial Summary

Table 5: Profit and Loss Statement
(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Operating Income (Sales)	14,226	14,407	15,314	18,964
<i>of which Exports</i>	0	0	0	0
<i>of which Domestic</i>	14,226	14,407	15,314	18,964
Operating Expenses	10,689	10,680	11,614	14,571
EBITDA	3,537	3,727	3,700	4,393
% margins	24.9	25.9	24.2	23.2
Depreciation & Amortisation	350	149	179	215
Gross Interest	597	1,506	1,746	2,106
Other Income	119	68	125	162
Recurring PBT	2,709	2,140	1,899	2,233
Add: Extraordinaries	0	0	0	0
Less: Taxes	426	428	456	581
- Current tax	426	428	456	581
Net Income (Reported)	2,283	1,712	1,444	1,653
Recurring Net Income	2,283	1,712	1,444	1,653

Source: Company data, I-Sec Research

Table 6: Balance Sheet
(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Assets				
Total Current Assets	31,516	34,542	39,613	46,671
<i>of which cash & cash eqv.</i>	287	1,078	1,422	1,808
Total Current Liabilities & Provisions	5,746	5,742	6,165	7,506
Net Current Assets	25,770	28,800	33,448	39,165
Investments				
<i>of which</i>	28	28	28	28
Strategic/Group	28	28	28	28
Other Marketable	0	0	0	0
Net Fixed Assets	2,142	2,488	2,948	3,549
<i>of which</i>				
intangibles	0	0	0	0
Capital Work-in-Progress	272	276	293	363
Goodwill	0	0	0	0
Total Assets	27,940	31,316	36,424	42,741
Liabilities				
Borrowings	17,831	19,831	23,831	28,831
Deferred Tax Liability	0	0	0	0
Minority Interest	228	228	228	228
Equity Share Capital	729	729	729	729
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	3,513	4,890	5,998	7,315
Net Worth	9,881	11,258	12,366	13,683
Total Liabilities	27,940	31,316	36,424	42,742

Source: Company data, I-Sec Research

Table 9: Quarterly trends
(Rs mn, year ending March 31)

	Dec-07	Mar-08	Jun-08	Sep-08
Net sales	3,553	4,741	3,468	2,934
% growth (YoY)	9.2	33.4	(26.9)	(15.4)
EBITDA	961	1,080	1,016	936
Margin (%)	27.0	22.8	29.3	31.9
Other income	4	24	20	19
Add: Extraordinaries	0	0	0	0
Net profit	611	702	505	490

Source: Company data

Table 7: Cash Flow Statement
(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Operating Cash flow	2,849	1,843	1,527	1,741
Working Capital Changes	(14,497)	(2,239)	(4,304)	(5,330)
Capital Commitments	(41)	(546)	(668)	(851)
Free Cash Flow	(11,689)	(941)	(3,445)	(4,440)
Cash flow from Investing Activities	119	68	125	162
Issue of Share Capital	0	0	0	0
Buyback of shares	0	0	0	0
Inc (Dec) in Borrowings	11,994	2,000	4,000	5,000
Dividend paid	(545)	(335)	(335)	(335)
Extraordinary Items	0	0	0	0
Chg. in Cash & Bank balance	(625)	791	344	386

Source: Company data, I-Sec Research

Table 8: Key Ratios
(Year ending March 31)

	FY08	FY09E	FY10E	FY11E
Per Share Data (Rs)				
EPS(Basic Recurring)	31.3	23.5	19.8	22.7
Diluted Recurring EPS	31.3	23.5	19.8	22.7
Recurring Cash EPS	36.1	25.5	22.3	25.6
Dividend per share (DPS)	6.5	4.0	4.0	4.0
Book Value per share (BV)	135.5	154.4	169.6	187.7
Growth Ratios (%)				
Operating Income	19.9	1.3	6.3	23.8
EBITDA	38.1	5.4	-0.7	18.7
Recurring Net Income	41.4	-25.0	-15.7	14.5
Diluted Recurring EPS	41.4	-25.0	-15.7	14.5
Diluted Recurring CEPS	41.6	-29.3	-12.8	15.1
Valuation Ratios (x)				
P/E	3.6	4.9	5.8	5.0
P/CEPS	3.2	4.5	5.1	4.5
P/BV	0.8	0.7	0.7	0.6
EV / EBITDA	7.3	7.3	8.3	8.0
EV / Operating Income	1.8	1.9	2.0	1.9
EV / Operating FCF	(2.2)	(28.7)	(8.9)	(8.0)
Operating Ratio				
Raw Material/Sales (%)	54.3	56.3	57.1	57.2
SG&A/Sales (%)	13.6	9.9	10.1	10.1
Other Income / PBT (%)	4.4	3.2	6.6	7.2
Effective Tax Rate (%)	15.7	20.0	24.0	26.0
NWC / Total Assets (%)	91.2	88.5	87.9	87.4
Inventory Turnover (days)	275.1	414.0	490.2	500.8
Receivables (days)	91.4	141.5	138.1	128.6
Payables (days)	49.8	65.4	62.7	58.7
D/E Ratio (x)	1.8	1.8	1.9	2.1
Return/Profitability Ratio (%)				
Recurring Net Income Margins	15.9	11.8	9.4	8.6
RoCE	13.1	9.8	8.2	8.1
RoNW	24.7	16.2	12.2	12.7
Dividend Payout Ratio	20.8	17.0	20.2	17.6
Dividend Yield	5.7	3.5	3.5	3.5
EBITDA Margins	24.9	25.9	24.2	23.2

Source: Company data, I-Sec Research

ANALYST CERTIFICATION

We I, *Gaurav Pathak, PGDM, BTech; Shaleen Silori, MBA (Finance), BTech* analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Gaurav Pathak, PGDM, BTech; Shaleen Silori, MBA (Finance), BTech* research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its affiliates collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that *Gaurav Pathak, PGDM, BTech; Shaleen Silori, MBA (Finance), BTech* research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed
