Sobha Developers

15 November 2011

Reuters: SOBH.BO; Bloomberg: SOBHA IN

2QFY12 Result Update

Rising debt level remains a concern

Sobha Developers' (SDL) 2QFY12 profit was below our expectation (7.7%) on account of lower revenue booking from existing projects, but it was marginally higher than consensus estimate (8.5%). Although SDL reported strong pre-sales amounting to Rs4.9bn (up 61% QoQ) in 2QFY12, the increase in net debt for the quarter by Rs657mn will be an overhang on the stock. We envisage no debt reduction in FY12 (management gave guidance of Rs3bn debt reduction in FY12) on lack of land sales and rising expenditure on new project launch. We maintain our Hold rating on the stock.

Lower revenue booking, but strong OPM: SDL reported a marginal 4% YoY (up 3.6% QoQ) revenue growth (adjusted for land sales) in 2QFY12, which was 15.2% below our expectation and 3.2% below consensus estimate on account of lower revenue recognition from the real estate segment. This was also on account of SDL's strategy to launch many projects at a time, which led to stretched project execution bandwidth and thereby delayed revenue recognition as the company follows the 25% threshold limit. However, EBITDA margin of 22.4% against our expectation of 20.5% was a positive surprise, thanks to lower land and construction cost associated with projects booked during the quarter.

Net debt increases QoQ, unlikely to reduce in FY12: Net debt increased by Rs657mn QoQ to Rs13.6bn (0.71x) in 2QFY12 on account of expenditure incurred on purchasing construction equipment (Rs458mn), stake purchase from Pan Atlantic (Rs571mn) and dividend payment (Rs 293mn).The company has been fairly successful in reducing its net debt-equity ratio from 0.8x in FY10 to 0.71x in 2QFY12 through land sales which will be challenging under the current environment and thereby any debt reduction hinges on operating cash flow, which remains weak currently. SDL has reported positive operating cash flow of Rs891mn in 1HFY12, but adjusted for capex (Rs558mn) and interest payment (Rs1,230mn) it is unlikely that SDL will be able to reduce its debt in FY12.

Outlook: We have tweaked our model to factor in higher OPM, strong pre-sales and lower revenue booking. Overall FY12/13 EPS estimates are broadly unchanged. At the CMP, SDL is trading at 1x P/BV and 9.6x P/E on FY13E earnings and at a 30% discount to our one-year forward NAV. The muted visibility on debt reduction and higher new launches in new cities offsets 30% discount to NAV. We assign a Hold rating on SDL at a TP of Rs227 at a 30% discount to our one-year forward NAV.

Hold

Sector: Real Estate

CMP: Rs226

Target Price: Rs227

Upside: 0%

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Key Data

Current Shares O/S (mn)	98.1
Mkt Cap (Rsbn/US$mn)	22.2/438.5
52 Wk H / L (Rs)	340/185
Daily Vol. (3M NSE Avg.)	130,993

Price Performance (%)

	1 M	6 M	1 Yr
Sobha	(0.3)	(15.1)	(28.7)
Nifty Index	0.1	(7.3)	(16.1)

Source: Bloomberg

Y/E March (Rsmn)	2QFY11	1QFY12	2QFY12	YoY (%)	QoQ (%)	1HFY11	1HFY12	YoY (%)
Sales	4,257*	3,167	3,274	*(23.1)*	*3.4*	7,413	6,441	*(13.1)*
Expenditure	3,337	2,556	2,539	*(23.9)*	*(0.7)*	5,867	5,095	*(13.2)*
Construction & land costs	2,584	1,819	1,711	*(33.8)*	*(5.9)*	4,433	3,530	*(20.4)*
Employee costs	273	306	316	*15.8*	*3.3*	523	622	*18.9*
Other expenditure	480	431	512	*6.7*	*18.8*	911	943	*3.5*
EBITDA	920	611	735	*(20.1)*	*20.3*	1,546	1,346	*(12.9)*
OPM (%)	*21.6*	*19.3*	*22.4*	*84bp*	*316bp*	*20.9*	*20.9*	*4bp*
Interest expenses	109	101	81	*(25.7)*	*(19.8)*	243	182	*(25.1)*
Depreciation	69	74	91	*31.9*	*23.0*	136	165	*21.3*
Other income	56	5	9	*(83.9)*	*80.0*	66	14	*(78.8)*
PBT	798	441	572	*(28.3)*	*29.7*	1,233	1,013	*(17.8)*
Tax	209	144	183	*(12.4)*	*27.1*	301	327	*8.6*
% PBT	26.2	32.7	32.0			24.4	32.3	
Share of profits from subsidiary		12.0	20.0		*66.7*	0	32	
Reported PAT	589	309	409	*(30.6)*	*32.4*	932	718	*(23.0)*
EPS (Rs)	6.0	3.1	4.2	*(30.6)*	*32.4*	9.5	7.3	*(23.0)*

Source: Company, Nirmal Bang Institutional Equities Research Note: Includes land sale of Rs1,140mn*

Exhibit 1: Financial summary

Y/E Mar (Rsmn)	FY09	FY10	FY11	FY12E	FY13E
Net sales	9,740	11,299	14,739	15,325	19,754
EBITDA	2,788	2,463	3,161	3,227	4,277
Net profit	1,078	1,341	1,813	1,729	2,313
EPS (Rs)	11.0	13.7	18.5	17.6	23.6
EPS growth (%)	*(52.8)*	*24.4*	*35.2*	*(4.6)*	*33.8*
EBITDA margin (%)	28.6	21.8	21.4	21.1	21.6
PER (x)	20.6	16.5	12.2	12.8	9.6
P/BV (x)	1.5	1.3	1.2	1.1	1.0
EV/EBITDA (x)	14.8	14.6	10.8	10.9	8.5
RoCE (%)	*8.4*	*6.9*	*9.2*	*9.1*	*11.2*
RoE (%)	*10.4*	*9.6*	*10.2*	*9.0*	*11.1*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Our estimates vs actuals

(Rsmn)	Actual 2QFY12	Nirmal Bang estimate 2QFY12	*Deviation (%)*	Bloomberg consensus 2QFY12	*Deviation (%)*
Revenue	3,274	3,862	*(15.2)*	3,382	*(3.2)*
EBITDA	735	792	*(7.2)*	744	*(1.2)*
OPM (%)	22.4	20.5	-	22.0	-
PAT	409	443	*(7.7)*	377	*8.5*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Contractual revenue in line, but lower revenue recognition hurts 2QFY12 realty revenue

Real estate revenue in 2QFY12 stood at Rs2,142mn, down 4.1% YoY (up 9.8% QoQ). The decline was primarily because of lower recognition of income, with the management citing a couple of key projects like Sobha Forest View not crossing the threshold limit as the reason. We believe it is also due to a combination of SDL's strategy to launch many projects at a time - which has led to stretched project execution bandwidth and thereby delayed revenue recognition - as the company follows the 25% threshold limit. Revenue from the contractual and manufacturing segment stood at Rs1,153mn, up 23.6% YoY (but down 6.1% QoQ) in line with our estimates. The company received new contracts worth nearly Rs112mn during 2QFY12, excluding Infosys Technologies. It added three new clients like Wipro, SKF and Skyline in 2QFY12. The estimated un-billed value of contracts on hand and forthcoming projects is about Rs9,750mn. The management has given revenue guidance of Rs5bn for FY12 from the contractual segment, which, we believe is achievable, given the existing order backlog.

Exhibit 3: Segmental break-up

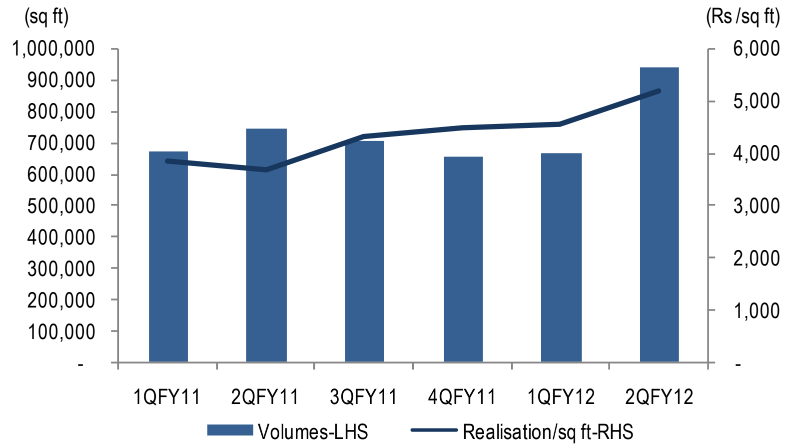
(Rsmn)	2QFY11	1QFY12	2QFY12	*QoQ (%)*	*YoY (%)*	1HFY11	1HFY12	*YoY (%)*
Real estate	2,234	1,951	2,142	*9.8*	*(4.1)*	4,465	4,093	*(8.3)*
% to total revenue	*70.5*	*61.4*	*65.0*	-	-	*70.6*	*63.2*	-
Contractual & manufacturing	933	1,228	1,153	*(6.1)*	*23.6*	1,858	2,381	*28.1*
% to total revenue	*29.5*	*38.6*	*35.0*	-	-	*29.4*	*36.8*	-
Total	**3,167**	**3,179**	**3,295**	*3.6*	*4.0*	**6,323**	**6,474**	*2.4*

Source: Company, Nirmal Bang Institutional Equities Research

Strong pre-sales; likely to achieve FY12 guidance

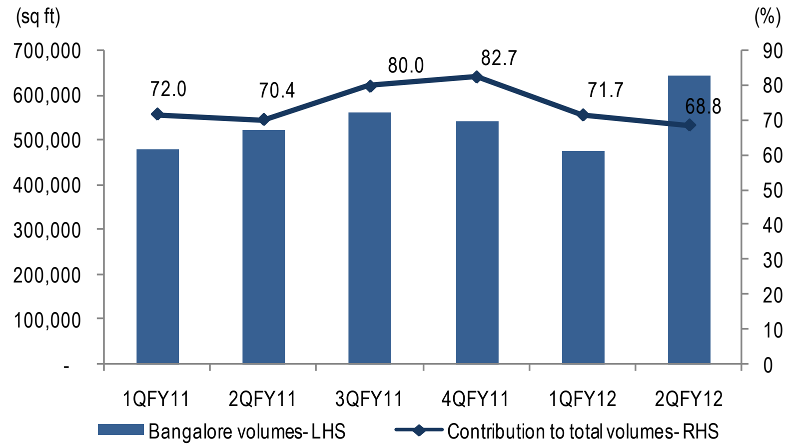
SDL reported strong pre-sales of Rs4.9bn (up 61% QoQ and 77.3% YoY) and a volume of 0.94mn sq ft (up 40.6% QoQ and 25.7% YoY), which was aided by Gurgaon project launch and pick-up in Bangalore volume. Average realisation stood at Rs5,196/sq ft (up 14.2% QoQ) aided by Gurgaon project launch at Rs9,500/sq ft. 2QFY12 witnessed highest sales run rate/quarter ever for South India property players like SDL and Prestige Estates. Going forward, sustainability of such volume (2QFY12) will be challenging in South India property market, given the global economic turmoil, as the Bangalore property market remains highly dependent on the IT/ITES segment. SDL has so far achieved 52.6% and 53.4% of its full year pre-sales (Rs 15bn) and volume (3-3.2mn sq ft) guidance, respectively. We have factored in 3mn sq ft of volume and Rs 14.6bn of pre-sales for FY12.

Exhibit 4: 2QFY12 realisation/volume aided by Gurgaon launch and pick-up in Bangalore volume



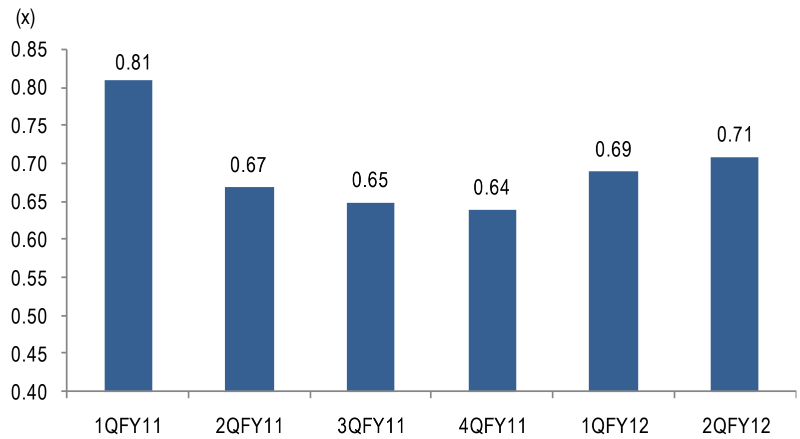
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Sustainability of volume in Bangalore will be challenging



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Net D/E ratio increases to 0.71x



Source: Company, Nirmal Bang Institutional Equities Research

Ratings track

Date	Rating	CMP (Rs)	Target price (Rs)
4 October 2011	HOLD	208	227
10 October 2011	HOLD	212	227

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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