

# SOBHA

## Growth story remains strong

India Equity Research | Real Estate

Sobha sustained its strong performance with Q4FY18 PAT at INR654mn (up 40% YoY) beating our estimate. Operations also remained strong with new sales of 1.02msf (up 40% YoY), valued at INR8.1bn (up 31% YoY). The 1.02msf sold in Q4FY18 was the highest in the past 12 quarters; management has guided for steady ramp up going ahead. Improving collections (~INR30bn in FY18, best ever) led to fall in leverage. Robust launch pipeline, market share gain, diversified land bank and improving cash flow trajectory continue to remain key positives. Maintain 'BUY' with TP of INR668/share.

### Going great guns

Sobha reported Q4FY18 revenue of INR7.7bn (up 30% YoY and 11% QoQ) driven by POCM-based revenue recognition in ongoing projects. EBITDA margin at 17.7% fell 215bps YoY and 269bps QoQ; PAT rose 40% YoY to INR654mn (INR606mn estimate), aided by high other income and lower depreciation. Declining interest cost (down to 9.39%; trend sustained for 13<sup>th</sup> consecutive quarter) aided profitability.

### Operations remain healthy

**Operations:** Q4FY18 new sales stood at INR8.1bn (up 46% YoY, 8% QoQ), measuring 1.02msf (up 40% YoY) with average realisation of INR6.5kpsf (down 7% YoY). Net debt fell by INR1.3bn QoQ and net gearing declined by 700bps to 79%, driven by strong collections during the quarter (INR9.1bn, up 31% YoY and 35% QoQ). The company intends to launch six-eight new projects in various geographies in ensuing quarters. Sobha has been generating positive cash flow (post interest and tax expenses) for the past 11 quarters. Management is planning to continue to scout for opportunistic land buys, while keeping an eye on cash flows and leverage (which it intends to maintain at ~80%). The order book of the contractual business rose to INR17.4bn (INR14.7bn in Q3FY18).

### Outlook and valuations: Steady growth trajectory; maintain 'BUY'

We expect sustained improvement in Sobha's cash flow driven by strong new sales momentum. Key stock catalysts include: 1) launch of planned projects; 2) improvement in Bengaluru residential demand; 3) steady sales momentum in *Dream Acres* project; 4) tax exemption for affordable housing; and 5) balance sheet improvement. We continue to maintain 'BUY/SO' with TP of INR668/share.

EDELWEISS 4D RATINGS	
Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equal weight

#### MARKET DATA (R: SOBHA.BO, B: SOBHA IN)

CMP	: INR 511
Target Price	: INR 668
52-week range (INR)	: 695 / 345
Share in issue (mn)	: 94.8
M cap (INR bn/USD mn)	: 48 / 709
Avg. Daily Vol.BSE/NSE('000)	: 446.8

#### SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	55.9	55.9	56.1
MF's, FI's & BK's	10.7	10.7	10.7
FII's	28.5	29.2	28.7
Others	4.9	4.1	4.5
* Promoters pledged shares (% of share in issue)	18.9		

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Real Estate Index
1 month	(3.7)	0.7	(2.9)
3 months	(5.0)	1.4	(7.0)
12 months	29.1	12.4	12.3

#### Financials

(INR mn)

Year to March	Q4FY18	Q4FY17	% chg	Q3FY18	% chg	FY18	FY19E	FY20E
Revenues	7,696	5,888	30.7	6,919	11.2	27,830	28,937	32,822
EBITDA	1,364	1,202	13.5	1,375	(0.8)	5,197	5,796	6,749
Net Profit	654	466	40.3	538	21.6	2,168	2,459	3,054
EPS (INR)	6.9	4.9	41.4	5.6	22.8	22.9	25.9	32.2
P/E (x)						22.4	19.7	15.9
ROE (%)						8.0	8.6	9.8

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### Management call: Key highlights

- **Diversification:** The Bengaluru market contributed 74% to overall sales volume during the quarter and 72% during FY18 (75% in FY17). Management believes that despite a subdued realty market in Bengaluru, the company will continue to gain market share with multiple launches in the pipeline.
- **New launches:** During the quarter, the company launched four projects with a total saleable area of 1.78msf.
- **Outlook:** Sobha expects to sustain its FY18 operations momentum in coming quarters as well. It is targeting to launch six-eight new projects (with a total project area of ~8msf) in Bengaluru, Mysore, Thrissur, Cochin and Ahmedabad in FY19. Management has guided for an improvement in new sales volume, realisations and profitability in FY19.
- **Real estate division:** This division contributed 65% to revenue during Q4FY18 (72% in FY18).
- **Manufacturing/contracting business:** Q4FY18 revenue for the division was INR2.7bn—INR1.7bn from contracting and balance from manufacturing. The division has received a large order worth ~INR5.6bn in Q1FY19 for the Azim Premji Campus.
- **Borrowing Cost:** Sobha's average borrowing cost has dipped 329bps since Q3FY15. It expects interest cost to fall by a further 15-20bps in coming quarters, driven by strong collections.

### Outlook and valuations: Sanguine outlook; maintain 'BUY'

We are positive on Sobha's prospects and expect its operations to continue to ramp up steadily going ahead. This is envisaged to be driven by: (a) likely uptick in Bengaluru residential demand driven by strong office space leasing in the past few years; (b) improved affordability; and (c) preference for organised players post RERA.

We have maintained our target price at INR668/share owing to the continued steady growth in operations.

Our FY19E real estate NAV is INR733/share, to which we apply 15% discount and add value of contractual business (INR44/share) to arrive at target price of INR668. We maintain 'BUY/SO' recommendation/rating.

## Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	7,696	5,888	30.7	6,919	11.2	27,830	28,937	32,822
Direct Operating expenses	4,705	3,436	36.9	4,250	10.7	16,800	17,548	20,088
Other expenses	1,627	1,250	30.2	1,294	25.7	5,833	5,593	5,985
Total expenditure	6,332	4,686	35.1	5,544	14.2	22,633	23,141	26,073
EBITDA	1,364	1,202	13.5	1,375	(0.8)	5,197	5,796	6,749
Depreciation	135	173	(22.0)	137	(1.5)	544	586	604
Interest	518	397	30.5	498	4.0	1,978	1,842	1,853
Other income	196	125	56.8	85	130.6	495	475	480
Profit before tax	907	757	19.8	825	9.9	3,170	3,843	4,772
Provision for taxes	253	297	(14.8)	291	(13.1)	1,002	1,383	1,718
Profit after tax	654	460	42.2	534	22.5	2,168	2,459	3,054
Minority interest	-	-	-	-	-	-	-	-
Associate profit share	-	(10)	(100.0)	-	-	-	-	-
Reported net profit	654	466	40.3	538	21.6	2,168	2,459	3,054
Diluted shares (mn)	95	96	(1.6)	95	-	95	95	95
Diluted EPS (INR)	6.9	4.9	41.4	5.6	22.8	22.9	25.9	32.2
Adjusted Diluted EPS	6.9	4.9	41.4	5.6	22.8	22.9	25.9	32.2
<b>as a % of net revenues</b>								
Cost of construction	61.1	58.4		61.4		60.4	60.6	61.2
Employee cost	6.8	7.3		6.8		-	-	-
Other expenses	14.3	13.9		11.9		81.3	80.0	79.4
Total expenses	82.3	79.6		80.1		81.3	80.0	79.4
EBITDA	17.7	20.4		19.9		18.7	20.0	20.6
Depreciation	1.8	2.9		2.0		2.0	2.0	1.8
EBIT	16.0	17.5		17.9		16.7	18.0	18.7
Interest expenditure	6.7	6.7		7.2		7.1	6.4	5.6
Reported net profit	8.5	7.9		7.8		7.8	8.5	9.3
Tax rate	27.9	39.2		35.3		31.6	36.0	36.0

### Company Description

Sobha is a Bangalore based real estate developer focused on developing residential space. 37% of its land bank is located in Bangalore, 22% in Kochi, 19% Chennai, 17% in Hosur and balance across key markets in South India. It also has presence in Gurgaon. The company has a backward integrated business model, with all operations from conceptualisation to execution done in house. It has acquired its land bank through outright acquisition as well as joint development agreement with land owners. Additionally Sobha undertakes contract for construction for third parties under its Contractual Business.

### Investment Theme

1. Sobha is expected to scale up operations over next few quarters, driven by planned new launches and improved affordability.
2. Plans are afoot to develop large land parcels
3. Proxy for stable Bangalore residential market, which has steady demand/supply momentum with moderate (8-10%) price increase
4. Steady cash flows from contractual business
5. Attractive valuations
6. See tailwinds from improvement in demand due to affordable housing incentives and tax exemption on development of affordable homes

### Key Risks

1. Adverse macros, viz., high interest rate, inflation and slow growth.
2. Physical market demand weakens, especially in Bangalore.
3. Approval delays leading to slower new sales.
4. IT slowdown impacting residential demand, especially in Bangalore

## Financial Statements

### Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
<b>Macro</b>				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
<b>Company</b>				
Selling Price increase (%)	5	5	5	5
Construction Cost Increase (%)	5	5	5	5

### Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Income from operations	22,290	27,830	28,937	32,822
Direct costs	13,020	16,800	17,548	20,088
Other expenses	5,073	5,833	5,593	5,985
Total operating expenses	18,093	22,633	23,141	26,073
EBITDA	4,197	5,197	5,796	6,749
Depreciation	638	544	586	604
EBIT	3,558	4,653	5,210	6,144
Less: Interest Expense	1,497	1,978	1,842	1,853
Add: Other income	386.1	495.00	475.00	480.00
Profit Before Tax	2,448	3,170	3,843	4,772
Less: Provision for Tax	970	1,002	1,383	1,718
Reported Profit	1,607	2,168	2,459	3,054
Adjusted Profit	1,607	2,168	2,459	3,054
Shares o /s (mn)	96	95	95	95
Adjusted Basic EPS	16.9	22.9	25.9	32.2
Diluted shares o/s (mn)	96	95	95	95
Adjusted Diluted EPS	16.9	22.9	25.9	32.2
Adjusted Cash EPS	23.3	28.6	32.1	38.6
Dividend per share (DPS)	2.5	7.0	3.5	3.5
Dividend Payout Ratio (%)	17.5	35.8	15.8	12.7

### Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
S G & A expenses	22.8	21.0	19.3	18.2
Operating expenses	81.2	81.3	80.0	79.4
Depreciation	2.9	2.0	2.0	1.8
EBITDA margins	18.8	18.7	20.0	20.6
Interest Expense	6.7	7.1	6.4	5.6
Net Profit margins	7.2	7.8	8.5	9.3

### Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	14.7	24.9	4.0	13.4
EBITDA	(5.3)	23.8	11.5	16.4
PBT	(3.6)	29.5	21.2	24.2
Adjusted Profit	16.6	34.9	13.4	24.2
EPS	16.6	34.9	13.4	24.2

Balance sheet (INR mn)				
As on 31st March	FY17	FY18	FY19E	FY20E
Share capital	963	948	948	948
Reserves & Surplus	25,482	26,751	28,823	31,489
Shareholders' funds	26,445	27,699	29,771	32,437
Long term borrowings	22,219	23,087	19,500	19,500
Def. Tax Liability (net)	2,283	2,521	2,521	2,521
<b>Sources of funds</b>	<b>50,948</b>	<b>53,307</b>	<b>51,792</b>	<b>54,458</b>
Gross Block	6,115	6,264	6,515	6,715
Net Block	5,153	4,758	4,423	4,018
Capital work in progress	799	1,345	1,100	1,200
Total Fixed Assets	5,952	6,103	5,523	5,218
Non current investments	-	1,125	1,125	1,125
Cash and Equivalents	1,468	1,194	2,297	3,327
Inventories	50,960	48,349	48,711	50,201
Trade receivables	6,590	7,755	8,392	9,518
Loans & Advances	23,961	25,722	24,104	23,856
Total current assets	81,510	81,826	81,207	83,575
Current liabilities	37,679	36,635	37,459	37,886
Provisions	304	306	900	901
Total Current Liab	37,983	36,941	38,359	38,787
Net Curr Assets-ex cash	43,527	44,885	42,848	44,788
<b>Uses of funds</b>	<b>50,948</b>	<b>53,307</b>	<b>51,792</b>	<b>54,458</b>
BVPS (INR)	274.6	292.0	313.9	342.0

Free cash flow (INR mn)				
Year to March	FY17	FY18	FY19E	FY20E
Reported Profit	1,607	2,168	2,459	3,054
Add: Depreciation	638	544	586	604
Interest (Net of Tax)	903	1,353	1,179	1,186
Less: Changes in WC	1,900	1,358	(2,037)	1,940
Operating cash flow	345	1,354	5,083	1,718
Less: Capex	(64)	149	251	200
<b>Free Cash Flow</b>	<b>1,313</b>	<b>2,558</b>	<b>6,011</b>	<b>2,704</b>

Cash flow metrics				
Year to March	FY17	FY18	FY19E	FY20E
Operating cash flow	345	1,354	5,083	1,718
Financing cash flow	(789)	(1,158)	(388)	(388)
Investing cash flow	575	(1,820)	(6)	(300)
Net cash Flow	131	(1,624)	4,689	1,030
Capex	64	(149)	(251)	(200)
Dividend paid	(281)	(776)	(388)	(388)
Share issue/(buyback)	(581)	(620)	-	-

Profitability and efficiency ratios				
Year to March	FY17	FY18	FY19E	FY20E
EOP (ROE) (%)	6.2	8.0	8.6	9.8
ROACE (%)	9.0	10.7	12.1	13.3
ROAE (%)	6.2	8.0	8.6	9.8
Current Ratio	2.2	2.2	2.2	2.2
Gross Debt/EBITDA	5.3	4.4	3.4	2.9
Gross Debt/Equity	0.8	0.8	0.7	0.6
Net Debt/Equity	0.8	0.8	0.6	0.5

Operating ratios				
Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	0.4	0.5	0.6	0.6
Fixed Asset Turnover	4.1	5.6	6.3	7.8
Equity Turnover	0.9	1.0	1.0	1.1

Valuation parameters				
Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	16.9	22.9	25.9	32.2
Y-o-Y growth (%)	16.6	34.9	13.4	24.2
Adjusted Cash EPS (INR)	23.3	28.6	32.1	38.6
Diluted P/E (x)	30.2	22.4	19.7	15.9
P/B (x)	1.9	1.8	1.6	1.5
Dividend Yield (%)	0.5	1.5	0.8	0.8

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Sobha Limited	709	19.7	15.9	1.6	1.5	8.6	9.8
Brigade Enterprises	480	19.2	16.9	1.3	1.3	7.2	7.7
Godrej Properties	2,369	44.8	33.9	4.7	4.2	13.0	13.0
Oberoi Realty	2,579	12.7	11.3	2.4	2.0	20.5	19.3
Sunteck Realty Limited	908	19.2	13.1	2.1	1.8	11.4	14.8
Median	-	19.2	15.9	2.1	1.8	11.4	13.0
AVERAGE	-	23.1	18.2	2.4	2.2	12.1	12.9

Source: Edelweiss research

## Additional Data

### Directors Data

Mr. Ravi PNC Menon	Chairman	Mr. J.C. Sharma	Vice Chairman & Managing Director
Mr. P. Ramakrishnan	Deputy Managing Director	Mr. R.V.S. Rao	Independent Director
Dr. S.K. Gupta	Independent Director	Mr. Anup Shah	Independent Director
Mr. M. Damodaran	Independent Director	Dr. Punita Kumar - Sinha	Independent Director

Auditors - S.R. Batliboi & Associates

*\*as per latest annual report*

### Holding – Top10

	Perc. Holding		Perc. Holding
Nordea Bank AB	5.64	Franklin Templeton	5.24
Schroder International	5.03	Adawi Invest	4.39
L&T Mutual Fund	3.75	Dimensional Fund Advisors	1.96
HSBC Global	1.90	Invesco	1.77
Vanguard Group	1.49	Government Pension Fund Global	1.19

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
18 Aug 2017	Platinum Asia Fund	Sell	1758158	385.01
18 Aug 2017	Franklin India High Growth Company Fund	Buy	1578451	385.00
08 Aug 2017	Platinum Asia Fund	Sell	1030835	379.00

*\*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
17-May-18	<b>Brigade Enterprises</b>	Muted quarter; sanguine outlook; <i>Result Update</i>	246	Buy
04-May-18	<b>Godrej Properties</b>	Targeting higher growth; <i>Result Update</i>	810	Hold
25-Apr-18	<b>Oberoi Realty</b>	Change in strategy to target higher growth; <i>Result Update</i>	569	Buy

#### Distribution of Ratings / Market Cap

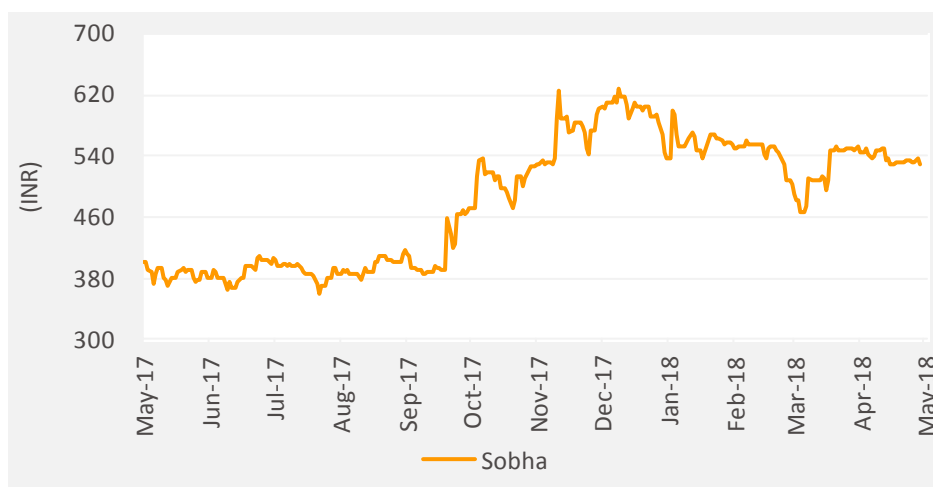
##### Edelweiss Research Coverage Universe

	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
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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