
Rating Rationale for Lodha Developers Limited’s proposed structured secured Non Convertible Debenture (NCD) Issue of ₹ 825 crores (INR Eight Hundred Twenty Five Crores)

NCD Issue Rating: BWR BBB+(SO)

Outlook : Stable

Brickwork Ratings (BWR) has assigned BWR BBB+(SO) (Pronounced Triple B Plus Structured Obligation) Rating for **Lodha Developers Ltd.’s (LDL)** proposed structured secured NCD issue of ₹ 825 crores. ‘BWR BBB+(SO)’ stands for an instrument that is considered to offer Moderate credit quality / safety in terms of timely servicing of principal and interest obligations.

The rating factors, inter alia, the experienced management team, healthy order book position of Lodha Developers, its dominance in the residential segment, and the underlying securities of the proposed NCD issue. The rating is however constrained by project execution risk and risk in timely launch and sale of new projects, very high leverage, a few instances of delays in debt servicing and instances of restructuring in the past and the current situation in the real estate industry.

BWR has essentially relied upon the audited financial results of Lodha Developers of FY10, estimates for FY11 (audited results are yet to be announced), projected financials and information and clarification provided by the issuer and its promoters, draft term sheet outlining the structure of the deal, and collateral value analysis.

Lodha Developers Ltd (LDL): Established in 1995, Lodha Developers Ltd is one of India’s premiere real estate developers. It is promoted by Mr. Mangal Prabhat Lodha, Mr. Abhishek Lodha and Mr. Abhinandan Lodha. LDL, the flagship company of the group is primarily focused on the Mumbai real estate market and operates in both residential and commercial real estate segments. So far the group has developed approximately 9.42 million square feet (“mn sft”) of saleable area. It currently owns a land bank of approximately 4238 acres (274 mn sft of saleable area), and 97% of this area falls within the Mumbai Metropolitan region.

The Lodha group is one of the largest players in residential real estate in India. Almost 90% of its saleable projects are residential, the commercial segment forming 10%. Within the residential space, Affordable housing forms 41% of its projects and Hi-End housing forms 31%.

Sales of residential units have recovered strongly after the slowdown in 2008; as of December 2010, 5971 units (6.2 mn sft) had been sold. The group is currently executing about 52 projects (51.88 mn sft) in and around Mumbai. It has sold 67% of 10.6 mn sft area launched in 2009 and 47% of 11.5 mn sft area launched in 2010 and plans to deliver 2.2 mn sft in FY11, 5.3 mn sft in FY12 and 6.9 mn sft in FY13. The employee strength of the group has steadily increased from 1296 in FY09 to 1600 in FY10 and over 2200 in FY11; of this approximately 60% of the employees are involved in Construction Management. The group has more than 300 people in customer care, sales and marketing.

Management

Established in 1980, the Lodha Group is promoted by Mr. Mangal Prabhat Lodha, who is the Chairman and Executive Director. Mr. Abhishek Lodha is the Managing Director and Mr. Abhinandan Lodha is a Deputy Managing Director of the company. Lodha Developers has eight directors on Board of which four are independent directors. The Company also has a highly experienced senior management team with an average of about 20 years' experience.

Brickwork has taken cognizance of press reports about the income tax raid on the Company in Jan 2011 and the demand notice for Rs. 60 crores served on the Company by the Income Tax Department

Structure:

As per the term sheet, the proposed NCD is secured by way of first and exclusive charge on security package consisting of following projects:

1. Lodha Luxuria, Thane (Phase I, II and III)
2. Lodha Bellissimo A, B & C
3. Lodha Aqua, Dahisar
4. Casa Essenza, Dahisar
5. Walkeshwar property, Walkeshwar
6. Lodha Platina, Anjur 100 acre township, Thane (All three phases)

Lodha Bellissimo A&B and C, Lodha Aqua, Casa Essenza and Lodha Luxuria - I were launched during Oct 2006 – April 2009 period and are expected to be completed between June 2011 and Dec 2012. The launched area is 2.96 mn sft of which 80% is already sold. The total value of the launched area is approximately ₹ 2900 crores and total cost of these projects is ₹ 1058 crores.

Lodha Luxuria II and III, Lodha Elitaire (Walkeshwar), Lodha Platina I, II and III are expected to be launched in FY12 and FY13 period and expected to be completed in FY15 to FY16 period.

Purpose of Issue: As per company, Lodha Group has agreed to purchase the Fully Convertible Debentures (FCDs) and Equity Shares issued by Cowtown Land Development Pvt Ltd (CLDPL) - a 100% subsidiary of Lodha Developers Ltd- held by Deutsche Bank. The issue proceeds will be utilized to purchase these FCD's.

The proposed NCD will have a tenure of 2 years, with quarterly interest payments and principal payment in phased manner starting December 2011. As we move forward in tenure of NCD, substantial part of cash flow that is required for servicing the NCD is expected to come from projects not yet launched. Hence we believe that the cash flows in escrow account may not fully cover quarter on quarter NCD repayment requirement. LDL may have to rely on surplus cash flows of other projects (which are not part of the escrow structure) to completely service this NCD.

Financial Performance –Lodha Developers: The Company recognizes revenue by percentage of completion method whereby 20% of sale value is recognized as revenue after 30% of construction cost (excluding land) is incurred and agreement for flat is registered. The Company has not yet announced the audited financial results for FY 11. As of FY10 consolidated net sales are at ₹ 1657.7 crores as against ₹ 950 crores as on FY09. The Operating profit margin and Net profit margin for FY10 were 46.2% and 16.4% respectively compared to 42.1% and 10.1% for FY09. As of FY10 interest cost as percentage of cash profits was approximately 50% compared to 71% in FY09 and 83% in FY08. In absolute terms company's interest outflow has substantially increased in FY11; however it is expected to decline in the next two years as the Company is planning to reduce its debt by approximately 25% in FY12 and FY13 each.

As on FY10 the company's consolidated net worth was ₹ 556.6 crores including goodwill of ₹606.5 crores and total borrowings were ₹ 3641.8 crores including fully convertible debentures of ₹ 1844.7 crores. By Dec 2010 the consolidated net worth increased to ₹ 945 crores including goodwill of ₹ 710 crores and total borrowings also increased to ₹ 4247.7 including fully convertible debentures of ₹ 1460 crores. During FY11 company repaid ₹ 1445 crores of debt which includes ₹ 1025 crores of FCD payments and borrowed approximately ₹ 2240 crores of which ₹ 500 crores were in the form of fully convertible debentures.

Historically the company is highly dependent on debt as indicated by high D/E for FY10 at 6.6x and 11.1x for FY09. The adjusted average D/E for past five years is (2006-2010) is 9.6x. The interest coverage ratio for FY10 stands at 2.45x versus 1.45x for FY09. The Debt Service Coverage Ratio is below 1 for FY09 as well as FY10 which reflects weak internal cash flows to service debt obligations. Current ratio stands at 1.7 compared to 2.1 for FY09. The Company also had contingent liabilities of ₹ 254 crores outstanding as on FY10; this is mainly on account of corporate guarantees given for borrowings by various SPV's.

Key Financials: Lodha Developers Ltd

(in ₹ mn)

	2007	2008	2009	2010
Income from core operations	1945.0	5477.8	9503.9	16577.4
EBITDA	1300.7	4069.0	4000.5	7656.0
PAT	428.5	541.1	956.6	2721.3
Capital Structure				
Net worth	1045.92	1868.33	2660.86	5566.67
Debt Funds	7308.06	24697.97	29549.48	36418.97
Debt/Equity (x)	7.16	13.23	11.19	6.60
Profitability				
EBITDA/Core Income (%)	66.9%	74.3%	42.1%	46.2%
PAT/Core Income (%)	22.0%	9.9%	10.1%	16.4%
ROCE (%)	13.75%	14.05%	11.09%	15.73%
Coverage				
Interest Coverage Ratio (x)	1.61	1.34	1.45	2.78
DSCR (x)	0.70	NM	0.65	0.65
Liquidity				
Current Ratio (x)	1.74	3.03	2.16	1.70
Net Cash Accruals to total debt (%)	5.8%	2.5%	3.6%	7.9%

Rating Outlook: Lodha Developers have a strong hold in residential segment of Mumbai Metropolitan Region (with 90% of its salable area as residential) where most of its land parcels are high yield mill lands and large land parcels which are ideal for township development. Company also has strong management team, healthy order book, presence across affordable, luxury, aspirational and Hi End customer segments and aggressive sales force. Currently company is simultaneously running 40 sites in across various parts of Mumbai; most of these are residential projects. Though company has strong workforce of 2500 people, this exhibits ambitious growth plans which generally leads to substantial funding requirements.

The rating is sensitive to the Company obtaining requisite regulatory approvals for all its projects, ability to launch and deliver projects on time, infusion of equity during the tenure of this NCD, and the FY 11 results which are yet to be announced maintain at the least, performance of FY10. The Rating is also sensitive to the sustainability of valuations and margins, ability to reduce leverage, creation of securities as per stipulations and the prevailing tight liquidity conditions in real estate industry. The Company's order book is also exposed to concentration risk as it is concentrated in Mumbai and its surrounding areas.

Overall, we believe that in the current scenario, the real estate sector is substantially exposed to project execution, funding, pricing and regulatory risks.

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Annexure I: Lodha Developers – Balance Sheet

(Rs. in Millions)

Year Ended	FY 07	FY 08	FY 09	FY 10
Liabilities				
Share Capital	0.60	1.22	12.27	1083.75
Share Application Fee	403.86	0	0.00	0.00
Reserves	641.46	1867.11	2648.59	4482.92
Net Worth	1045.92	1868.33	2660.86	5566.67
Secured Loan	7052.27	7929.17	10006.89	12577.73
Unsecured Loan	255.79	16768.8	19542.59	23841.24
Total Borrowings	7308.06	24697.97	29549.48	36418.97
Minority Interest	141.17	230.51	257.28	424.86
Current Liabilities	4615.1	7400.46	10810.53	19843.84
Deferred Liabilities / (assets)	-21.58	-72.02	-196.96	-81.47
Total Liabilities	13088.67	34125.25	43081.19	62172.87
Assets :				
Net Block + CWIP	178.31	667.64	2084.66	2517.30
Goodwill	1974.77	2692.35	2740.33	6065.7
Investments	50.1	646.44	200.71	2078.05
Current Assets	10885.49	30118.82	38055.49	51511.82
Total Assets	13088.67	34125.25	43081.19	62172.87

Annexure II: Lodha Developers – Income Statement

	FY 07	FY 08	FY 09	FY 10
Net Sales	1945.0	5477.8	9503.9	16577.4
Expenditure	1332.4	3997.7	7959.7	11301.5
Operating Profit	1300.7	4069.0	4000.5	7656.0
Depreciation	8.3	75.2	133.8	177.2
EBIT	1292.4	3993.8	3866.7	7478.8
Other Income	3.5	6.8	2.2	11.4
Interest	809.4	3045.8	2751.7	2757.5
Extraordinary Income / Gains	0.0	-19.0	-17.6	13.5
PBT	486.5	973.7	1134.8	4719.3
Tax	-1.7	327.0	172.5	1713.9
Minority Interest	59.7	105.6	5.6	284.0
PAT	428.5	541.1	956.6	2721.3