September 14, 2020

Sobha Limited: Ratings reaffirmed; rating withdrawn for Rs. 50.0 crore NCD programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Term Loan	2533.40	2485.50	[ICRA]A+(Negative) reaffirmed
Fund-based – Working Capital	955.00	970.00	[ICRA]A+(Negative) reaffirmed
Non-fund Based Facilities	733.30	717.40	[ICRA]A+(Negative) reaffirmed
Non-convertible Debentures	270.00	270.00	[ICRA]A+(Negative) reaffirmed
Non-convertible Debentures	50.00	0.00	[ICRA]A+(Negative) reaffirmed and withdrawn
Total	**4541.70**	**4442.90**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to take into account Sobha's established position in the Bengaluru real estate market and its strong in-house project execution capabilities in the real estate and contracting sectors. The company has maintained steady sales volume over the last couple of years. It witnessed sales volume of 4.07 million sqft in FY2020, as compared to 4.03 million sqft sold in FY2019. In Q1FY2021, despite disruption in operations due to the outbreak of Covid-19 pandemic, the company observed reasonable sales momentum. The receivables from the sold area in the completed and ongoing projects cover 45% of the pending cost and the debt outstanding as on June 30, 2020. The rating draws comfort from the contracting segment's healthy order-book position, which provides medium-term cash flow visibility. Further, in-house manufacturing division of Sobha, including Glazing and Metal works, Interiors, and concrete products, augments the real-estate and contracts works operations through benefits arising out of backward integration.

The rating continues to be constrained by the moderately high debt levels, which increased over FY2020. During FY2020, Sobha witnessed higher outflows in relation to the collections from customers due to the finishing costs in recently completed projects, higher outflows towards construction of land-owner share of built-up area in a project, and lower than anticipated collections from certain newly launched projects. Currently, the company's net debt levels stand at Rs. 3,021 crore and the net debt to equity ratio at 1.24 times as on June 30, 2020. The debt levels have historically been high compared to the ongoing project portfolio of the company due to the investment in land bank at the time of IPO. The rating is also restricted by the geographical concentration risk as most of the company's projects are located in Bengaluru city. Any slowdown in sales in the Bengaluru market could adversely impact the company's sales and collections. However, the company plans to expand into new geographies such as Hyderabad, Delhi, Hosur and Trivandrum to reduce the concentration on Bangalore.

Further, ICRA notes the adverse impact of Covid-19 pandemic on the operations of the company, with reduced sales, collections and construction in ongoing projects during the lockdown phase. The company has reported marginally positive free cash flows in Q1FY2021, aided by recovery of billings made in previous quarter and cost control measures adopted. With the impact of pandemic expected to continue into Q2FY2021, particularly in Bangalore (Sobha's key market), recovery in sales and construction pace to earlier levels is expected from mid-Q3 onwards. Material reduction in debt levels would be contingent on improvement in net operational cash flows and control over land investments, as guided by the management.

The Negative outlook on the [ICRA]A+ rating reflects ICRA's opinion that Sobha's credit profile will be under pressure in case the leverage remains at current levels on sustained basis. The adverse impact of Covid-19 on the operations of the company may constrain its ability to reduce debt materially in the near term. Further, any substantial land bank investment or any capital expenditure in the medium term, would be a key monitorable.

The ratings for the Rs. 50.0 crore NCD programme has been withdrawn at the request of the company and upon receipt of no dues certificate from the debenture trustee, in accordance with ICRA's policy on withdrawal and suspension of credit rating.

Key rating drivers and their description

Credit strengths

Established brand and market position - Sobha has a track record of over 25 years in the Bangalore real estate market. The company has strong in-house project execution capabilities demonstrated through completion of real estate projects with total development measuring 58.7 million sqft, and contractual projects, measuring 51.0 million sqft.

Steady pre-sales in FY2020; reasonable sales momentum maintained in Q1FY2021 – Sobha maintained steady sales volume over the last couple of years. The company reported sales volume of 4.07 million sqft in FY2020, as compared to 4.03 million sqft sold in FY2019. In Q1FY2021, despite disruption in operations due to the outbreak of Covid-19 pandemic, the company observed reasonable sales momentum with sales of 0.65 million sqft. Low completed inventory stock and healthy pre-sales in majority of the projects, demonstrates healthy saleability. In the ongoing projects, Sobha has achieved booking for 56% of the launched area as on June 30, 2020. Sobha has pending cash inflows from the sold area worth Rs. 3,185 crore, covering 45% of the balance project cost (Rs 4,058 crore) and net debt outstanding (Rs 3,021 crore). Though the same has declined in recent quarters due to reclassification of receivables against some identified probable cancellations, it remains at comfortable levels and has improved from 43% as on March 31, 2020.

Strong contractual order book provides steady cash flow; in-house manufacturing division augments operations - In the contractual business, the company reported orders in-hand worth Rs. 2,366 crore as on June 30, 2020. The order book is 2.3 times of the FY2020 contractual revenues, lending healthy revenue visibility for the medium term. Going forward, changing trends being observed in work policies, especially in the IT/ITeS sector, might have an impact on the future order inflow prospects. Nevertheless, over the last 12-15 months, Sobha's dependence on orders from IT/ITeS enabled companies has moderated to some extent, on the back of large orders received from clients like Azim Premji University, LuLu Mall and GAR Corporation. Further, in-house manufacturing division of Sobha, including Glazing and Metal works, Interiors, and concrete products, augments the real-estate and contracts works operations through benefits arising out of backward integration.

Credit challenges

Moderately high leverage – Sobha has moderately high debt levels, which increased over FY2020, and constrains the company's financial risk profile. During FY2020 Sobha witnessed higher outflows in relation to the collections from customers due to the finishing costs in recently completed projects, higher outflows towards construction of land-owner share of built-up area in a project, and lower than anticipated collections from certain newly launched projects. Currently, the company's net debt levels stand at Rs. 3,021 crore and the net debt to equity ratio at 1.24 times as on June 30, 2020. Notwithstanding marginal reduction in debt levels over Q4FY2020 and Q1FY2021, further reduction in debt levels may be hindered by disruption of operations due to the ongoing pandemic. The debt levels have historically been high compared to the ongoing project portfolio of the company due to the investment in land bank at the time of IPO. Unlocking the land bank potential through project launches would be essential to maintain healthy cash flow covers. Moreover, high scheduled debt repayment obligations expose Sobha to refinancing risks. However, cushion in terms of undrawn bank loans provides comfort to an extent

Geographical and project concentration risks - The company has high geographical concentration as around 74% of the sales by volume came from the Bengaluru real estate market in FY2020. Any slowdown in sales in Bengaluru market could adversely impact the company's sales and collections. However, presence of significant inventory in projects across cities like Cochin, Gurgaon and Pune along with future plans of 14.4 million sqft of residential launches and 0.39 million sqft of commercial launches in the coming quarters across geographies such Hyderabad, Delhi, Hosur and Trivandrum, the risk is mitigated to an extent.

Adverse impact of Covid-19 pandemic on company operations – The lockdowns imposed during April 2020 due to the outbreak of Covid-19 pandemic, adversely impacted real estate and construction operations. During Q1FY2021, inflows from real estate and contractual & manufacturing segments declined by 43% and 25% on a Y-o-Y basis. Nevertheless, moderation in outflows towards construction activity, and savings in overhead costs have led to improved net operational cashflows in Q1FY2021 vis-à-vis Q1FY2020. This coupled with deferment of land payments/investments and capital expenditure plans, resulted in marginally positive free cash flow. With the impact of pandemic expected to continue into Q2FY2021, particularly in Bangalore (Sobha's key market), recovery in sales and construction progress to earlier levels is expected from mid-Q3 onwards.

Liquidity position: Adequate

Sobha's liquidity is **adequate.** The company's cash from operations is expected to moderate in FY2021 on account of the Covid-19 pandemic impact; nonetheless, it is expected to be adequate to meet the finance costs and investing cash outflows of the company in FY2021. Sobha had undrawn debt limits of Rs. 1362 crore and liquid investments and bank balances of Rs. 104 crore, as on June 30, 2020. The Group has availed the benefit of the moratorium on bank loan payments as per the RBI Covid regulatory package. The company remains reliant on refinancing or drawdown of new project loans to some extent, with scheduled repayments of around Rs. 457 crore due in Q2-Q4 FY2021 and Rs. 737 crore in FY2022.

Rating sensitivities

Positive triggers – Improvement in net operational cash flows from the real estate and contracting division resulting in meaningful reduction in debt levels.

Negative triggers – If lower-than-expected pre-sales and collections enhances the refinancing requirement for the maturing debt obligations or higher than anticipated land investments result in further increase in debt levels.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology](#) [Rating Methodology for Real Estate Entities](#) [Rating Methodology for Construction Entities](#)
Parent/Group Support	Not applicable
Consolidation/Standalone	ICRA has taken a consolidated view of Sobha Limited and its seven subsidiaries, based on the strong operational and financial linkages between the group entities and their common management group.

About the company

Incorporated in August 1995, as a private limited company, and subsequently converted into a public limited company in June 2006, Sobha Limited is an established player in real estate development and contract construction in Bengaluru. Sobha is promoted by its chairman emeritus Mr. P. N. C. Menon, who started his India operations after successfully running interior decoration firms in Muscat. Along with his family members, he holds around 51.90% of equity shares in the company. As on June 30, 2020, Sobha executed real estate projects with an overall development of 58.7 million sqft of built-up area, with a major presence in Bengaluru. It has also diversified to other cities such as Gurgaon, Chennai, Pune, Thrissur, Coimbatore, Kochi, Calicut, Mysore and Gujarat. In the contracting segment, Sobha has completed projects in several states in India, covering a total built-up area of 51.0 million sqft.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	3442.1	3753.8
PAT (Rs. crore)	297.0	281.4
OPBDIT/OI (%)	19.6%	29.7%
PAT/OI (%)	8.6%	7.5%
Total Outside Liabilities/Tangible Net Worth (times)	3.8	3.5
Total Debt/OPBDIT (times)	3.9	2.8
Interest Coverage (times)	2.9	1.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding*	Rating	FY2020		FY2019	FY2018	
					14-Sep-2020	20-Feb-2020	29-July-2019	14-Sep-2018	07-Sep-2017	23-Aug-2017
1	Long-term Term Loan	Long Term	2485.50	2467.0	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Long-term Fund Based	Long Term	970.00	NA	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	Long-term Non-fund Based	Long Term	717.40	NA	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	Proposed Non-convertible Debentures	Long Term	270.00	-	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	-	-	-	-
5	Non-convertible Debentures	Long Term	0.0	0.0	[ICRA]A+ (Negative); withdrawn	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
6	Commercial Paper	Short Term	-	-	-	-	Withdrawn	[ICRA]A1	[ICRA]A1	[ICRA]A1

*Amount in Rs. Crore; *As on June 30, 2020.*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans	FY2014-FY2021	-	FY2021-FY2034	2485.50	[ICRA]A+ (Negative)
NA	Fund Based - Working capital	-	-	-	970.00	[ICRA]A+ (Negative)
NA	Non-fund based - Working capital	-	-	-	717.40	[ICRA]A+ (Negative)
INE671H07251 INE671H07277 INE671H07301	Non-convertible debentures	03/03/2016 11/03/2016 21/03/2016	11.40%	03/03/2020 11/03/2020 21/03/2020	10.00 20.00 20.00	[ICRA]A+ (Negative); withdrawn
NA	Proposed NCD	-	-	-	270.00	[ICRA]A+ (Negative)

Source: Sobha Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Sobha City [‘Partnership firm’]	100.00%	Full Consolidation
Sobha Construction Products Pvt Ltd	100.00%	Full Consolidation
Sobha Developers (Pune) Limited	100.00%	Full Consolidation
Sobha Assets Private Limited	100.00%	Full Consolidation
Sobha Highrise Ventures Private Limited	100.00%	Full Consolidation
Sobha Nandambakkam Developers Limited	100.00%	Full Consolidation
Sobha Tambaram Developers Limited	100.00%	Full Consolidation
Kondhwa Projects LLP	50.00%	Equity method

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About ICRA Limited:

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