

February 20, 2020

Sobha Limited: Long-term rating reaffirmed at [ICRA]A+; outlook revised from Stable to Negative; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Term Loan	2598.40	2533.40	[ICRA]A+ reaffirmed; outlook revised from Stable to Negative
Fund-based – Working Capital	890.00	955.00	[ICRA]A+ reaffirmed; outlook revised from Stable to Negative
Non-fund Based Facilities	733.30	733.30	[ICRA]A+ reaffirmed; outlook revised from Stable to Negative
Non-convertible Debentures	140.00	50.00	[ICRA]A+ reaffirmed; outlook revised from Stable to Negative
Non-convertible Debentures	-	270.00	[ICRA]A+ (Negative) assigned
Total	4361.70	4541.70	

*Instrument details are provided in Annexure-1

Rationale

The revision in outlook takes into consideration the decline in net cash flows from operations from the real estate and contracting divisions of Sobha Limited (Sobha) during 9MFY2020. The real estate division reported 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. In the contracting segment, the net cash flows were lower due to pending achievement of billing milestones in certain ongoing projects. The reduced net operational cash flow was inadequate to cover the financial charges on external borrowings. The free cash flows have been further impacted by capital expenditure and land payments, resulting in higher than anticipated debt levels.

The rating reaffirmation continues to take into account Sobha' established position in the Bengaluru real estate market and its strong in-house project execution capabilities in the real estate and contracting sectors. These strengths have translated into steady sales in the ongoing projects. The company witnessed 9% growth in the total area sold in 9M FY2020 as compared to 9M FY2019. The rating draws comfort from the contracting segment's healthy order-book position, which provides medium-term cash flow visibility. The receivables from the sold area in the completed and ongoing projects cover 55% of the pending cost and the debt outstanding as on December 31, 2019. The company has been consistently reporting average sales of over 1 million square feet (sqft) per quarter as against the unsold inventory from its launched projects of 7.92 million sqft (including 0.27 million sqft in completed projects) as on December 31, 2019.

The rating continues to be constrained by the high debt levels relative to the ongoing project portfolio. The elevated debt levels are on account of the high land bank investments made by the company historically. The large debt repayment obligations in the medium term necessitate timely debt refinancing. However, ICRA takes comfort from the undrawn bank loans available with the company, which provide cash buffer and financial flexibility to a large extent. The rating is also constrained 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 enter new geographies such as Hyderabad, Delhi, Hosur and Trivandrum to reduce the dependency on Bangalore. The company is also exposed to external risks such as cyclicity in the real estate industry, apart from regulatory risks inherent to the sector.

Key rating drivers

Credit strengths

Established brand and market position: Sobha has a track record of 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 56.89 million sqft, and contractual projects, measuring 49.93 million sqft.

Steady pre-sales: Sobha has a low completed inventory and continues to witness healthy sales in most projects. In the 52 ongoing projects, it achieved booking for 58% of the launched area as on December 31, 2019. The company has demonstrated steady sales volume with a total 3.17 million sqft sold in 9M FY2020, a growth of 9% over 9M FY2019. In comparison, the unsold inventory from the launched projects stood at 7.92 million sqft as on December 31, 2019. Sobha has pending cash inflows from the sold area worth Rs. 4,282 crore, covering 55% of the balance project cost (Rs 4,650 crore) and debt outstanding (Rs 3,094 crore). The same has improved from 49% as on March 31, 2019. Moreover, Sobha also has stock worth Rs. 5,347 crore from the area not offered for sale in the ongoing projects as of December 2019.

Strong contractual order book provides steady cash flow: In the contractual business, the company reported orders in-hand worth Rs. 2,203 crore as on December 31, 2019. The order book is 1.9 times of the FY2019 contractual revenues.

Credit challenges

Decline in cash flow from operations resulting in higher than anticipated debt: Collections during 9M-FY2020 have been weak when compared to the cash outflows. The construction spend has been significantly higher resulting in inadequate net operational cashflows in relation to the financing and investing outflows in the first nine months of the fiscal. As a result, the company's debt levels increased to Rs. 3,208 crore and the net debt to equity ratio to 1.30 times as on December 31, 2019. The debt levels have historically been high compared to the ongoing project portfolio of the company due to the high investment in land bank. 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 73% of the sales by volume and value came from the Bengaluru real estate market in 9MFY2020. Within the Bengaluru market, Sobha Dream Acres (SDA) continues to be the largest selling project, with a contribution of around 17% of the total sales volume in 9M FY2020. Any slowdown in sales in the SDA project or Bengaluru market could adversely impact the company's sales and collections. However, with 13.64 million sqft of residential launches and 0.44 million sqft of commercial launches in the coming quarters across geographies such Hyderabad, Delhi, Hosur and Trivandrum, the risk is mitigated to an extent.

Exposure to cyclicity and regulatory risks inherent to the sector: Being a cyclical industry, real estate is highly dependent on macro-economic factors. The company remains exposed to any slowdown in the economy and decrease in housing demand or property prices.

Liquidity position

Notwithstanding the decline in cash flow from operations in 9MFY2020, the company has receivables from sold area in ongoing projects, which can cover around 92% of the pending costs. Moreover, the company has demonstrated steady sales volumes, which further support the receipt of customer collections in coming quarters. To meet the maturing principal repayment obligations, the company will be reliant on refinancing to some extent by availing project loans against the new projects. Going forward, its refinancing requirements are likely to remain high, with repayments of around Rs 571 crore due in FY2021. As on December 31, 2019, the company had an available liquidity cushion of around Rs. 114 crore in the form of liquid investments and bank balances and Rs. 1059 crore in the form of sanctioned and undrawn working capital and term loan limits.

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	The ratings are based on the consolidated financial profile of the entity

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 51.75% of equity shares in the company. As on December 31, 2019, Sobha executed real estate projects with an overall development of 56.89 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 49.93 million sqft.

Key financial indicators (consolidated)

	FY2018	FY2019
Operating Income (Rs. crore)	2783.0	3442.1
PAT (Rs. crore)	216.9	297.0
OPBDIT/OI (%)	19.0%	19.6%
RoCE (%)	10.1%	13.9%
Total Debt/TNW (times)	0.8	1.2
Total Debt/OPBDIT (times)	4.4	3.9
Interest Coverage (times)	2.7	2.9

Source: company, ICRA; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit after Tax; TNW: Tangible Net Worth; RoCE; Return on Capital Employed; OI: Operating Income

Status of non-cooperation with previous CRA:

In April 2018, the rating for Sobha Limited assigned by CARE had been moved to 'CARE A; Issuer Not Cooperating; Based on best available information' as the company had not paid the surveillance fee for the rating exercise.

Any other information: None

Rating history for last three years

Current Rating (FY2020)						Chronology of Rating History for the past 3 years			
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jan'20 (Rs. crore)	Date & Rating		Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	
				Feb 2020	July 2019				
1 Long-term Term Loan	Long Term	2533.4	2533.4	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	
2 Long-term Fund Based	Long Term	955.0	747.7	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	
3 Long-term Non-fund Based	Long Term	733.3	548.9	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	
4 Non-convertible Debentures	Long Term	50.0	50.0	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	
5 Non-convertible Debentures	Long Term	270.0	-	[ICRA]A+ (Negative)	-	-	-	-	
6 Commercial Paper	Short Term	-	-	-	Withdrawn	[ICRA]A1	[ICRA]A1	-	

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 No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs Crore)	Current Rating and Outlook
NA	Term loans	FY2014-FY2020	-	December 2029	2533.40	[ICRA]A+ (Negative)
NA	Fund Based - Working capital	-	-	-	955.00	[ICRA]A+ (Negative)
NA	Non-fund based - Working capital	-	-	-	733.30	[ICRA]A+ (Negative)
INE671H07251	Non-convertible debentures	03/03/2016	11.40%	03/03/2020	10.00	[ICRA]A+ (Negative)
INE671H07277		11/03/2016		11/03/2020	20.00	
INE671H07301		21/03/2016		21/03/2020	20.00	
NA	Proposed NCD	-	-	-	270.00	

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 Contracting Pvt Ltd	100.00%	Full Consolidation
Sobha Developers (Pune) Limited	100.00%	Full Consolidation
Sobha Assets Private Limited	100.00%	Full Consolidation
SobhaHighrise Ventures Private Limited*	100.00%	Full Consolidation
SobhaNandambakkam Developers Limited	100.00%	Full Consolidation
Sobha Tambaram Developers Limited	100.00%	Full Consolidation
Vayaloor Properties Private Limited	100.00%	Full Consolidation
Vayaloor Builders Private Limited	100.00%	Full Consolidation
Vayaloor Developers Private Limited	100.00%	Full Consolidation
Vayaloor Real Estate Private Limited	100.00%	Full Consolidation
Vayaloor Realtors Private Limited	100.00%	Full Consolidation
ValasaiVettikadu Realtors Private Limited	100.00%	Full Consolidation
Kondhwa Projects LLP	50.00%	Equity method

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