

March 24, 2022

Sobha Limited: Ratings reaffirmed

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|----------------------------|-----------------------------------|----------------------------------|-----------------------------|
| Term Loans | 2569.30 | 2399.40 | [ICRA]A+(Stable) reaffirmed |
| Working Capital Facilities | 910.00 | 1079.90 | [ICRA]A+(Stable) reaffirmed |
| Non-fund Based Facilities | 693.60 | 693.60 | [ICRA]A+(Stable) reaffirmed |
| Total | 4172.90 | 4172.90 | |

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation take into account Sobha Limited (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 continues to witness strong sales and collections; in 9MFY2022, sales volume stood at 3.57 million sqft, as compared to 4.01 million sqft and 4.07 million sqft sold in FY2021 and FY2020 respectively. The rating draws comfort from the healthy saleability in the ongoing projects. Unsold inventory in ongoing and completed projects is around 6.43 million sqft in comparison to the track record of over 4 million sqft of annual sales in recent years. Sobha's pipeline of planned launches is expected to support healthy sales volumes going forward as well. The receivables from the sold area in the completed and ongoing projects cover 61% of the pending cost and the debt outstanding as on December 31, 2021. The rating further draws comfort from the contracting segment's adequate order-book position and Sobha's ability to win repeat orders from its existing clientele, providing 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 leverage level (as measured by net debt/FFO), which is estimated to be at around 3.8 times as on December 31, 2021, notwithstanding the improvement seen in FY2021 and 9MFY2022. Improved net operational cashflows and limited investing outflows have enabled reduction in net debt levels by Rs. 198 crore during 9MFY2022. The debt levels have historically been high compared to the net working capital gap for ongoing project portfolio of the company due to the investment in land bank made earlier. Moderately high scheduled debt repayment obligations and dependence on working capital limits expose Sobha to refinancing risks. However, with substantial project launches planned in the coming quarters, healthy project saleability, and company's intent towards restricting any significant investment outflows in the near-to-medium, net debt levels are expected to further reduce in the coming years. 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, with presence of significant inventory in projects across cities like Cochin, Gurgaon and Pune along with expected future launches across geographies such Hyderabad, Gurugram, Hosur and Trivandrum, the risk is mitigated to an extent. Further, the company remains exposed to external factors such as the inherent cyclicity in the real estate industry and regulatory risks.

The Stable outlook on the [ICRA]A+ rating reflects ICRA's opinion that the credit profile of Sobha will remain supported by the company's established brand recall in the real estate market and strong marketability across majority of its projects. Further, absence of substantial land bank investment or capital expenditure in the medium term, would help keep debt levels in check.

Key rating drivers and their description

Credit strengths

Established brand and market position - Sobha has a track record of over 27 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 61.50 million sqft, and contractual projects, measuring 54.40 million sqft, as of December 31, 2021.

Improved pre-sales in 9MFY2022 and steady margins leading to improved net operational cash-flows - The company continues to witness strong sales and collections; in 9MFY2022, sales volume stood at 3.57 million sqft, as compared to 4.01 million sqft and 4.07 million sqft sold in FY2021 and FY2020 respectively. Given the strong sales and collections witnessed in recent quarters, Sobha is expected to record double-digit growth both in annual sales volume and net operational cash-flows for the full year of FY2022. The company continues to maintain low completed inventory stock, which coupled with healthy pre-sales in majority of the projects, demonstrates healthy saleability. As of December 31, 2021, cover of cash inflows from sold area over balance project cost and net debt outstanding, stands comfortable at 61%. This is supported by strong sales bookings of 69% of the launched area as on December 31, 2021. Sobha's pipeline of planned launches is expected to support healthy sales volumes going forward as well.

Adequate contractual order book provides steady cash flow; repeat orders from existing clientele provides comfort – As of December 31, 2021, the company reported orders in-hand worth Rs. 2,348 crore, which is 4.4 and 2.3 times of the FY2021 and FY2020 revenues from the segment respectively, lending adequate revenue visibility for the medium term. Inflows from the segment continue to remain impacted due to disruption caused by the pandemic. Deferment of expansion plans of corporates have been the key reason for slow growth in the demand for contract works in recent past. With reduced pandemic levels, demand in the segment has witnessed increased traction in recent months and hence inflows are expected to improve from FY2023 onwards.

Credit challenges

Moderate leverage levels; however, expected to reduce in the medium term – Improved net operational cash flows coupled with reduced investment outflows have resulted in reduction in debt levels during the period to Rs. 2654 crore as on December 31, 2021 from Rs. 2852 crore as on March 31, 2021. Despite the substantial debt reduction witnessed in 9MFY2022, leverage levels (as measured by net debt/FFO) remain moderately high at around 3.8 times as of December 31, 2021. The debt levels have historically been high compared to the net working capital gap for ongoing project portfolio of the company due to the investment in land bank made earlier. Moderately high scheduled debt repayment obligations and dependence on working capital limits expose Sobha to refinancing risks. However, with substantial project launches planned in the coming quarters, healthy project saleability, and company's intent towards restricting any significant investment outflows in the near-to-medium, net debt levels are expected to further reduce in the coming years.

Geographical and project concentration risks - The company has high geographical concentration as around 68% of the sales by volume came from the Bengaluru real estate market in 9MFY2022. Any slowdown in sales in Bengaluru market could adversely impact the company's sales and collections. However, with presence of significant inventory in projects across cities like Cochin, Gurgaon and Pune along with future plans of 13.41 million sqft of residential launches (as of December 31, 2021) in the coming quarters across geographies such Hyderabad, Gurugram, Hosur and Trivandrum, the risk is mitigated to an extent.

Sensitive to external market factors – The company's operations remain susceptible to any severe lockdown restrictions that could be imposed following a surge in pandemic levels in future. Nevertheless, as observed in recent past, the company's preparedness towards such disruptions have improved. Further, the company remains exposed to other external factors such

as the inherent cyclical nature in the real estate industry and regulatory risks, which could have an impact on the cash inflows of the company.

Liquidity position: Adequate

Sobha's liquidity is adequate. The company has continued to witness healthy cashflow from operations over the last eight quarters, despite the adverse impact of pandemic. Operational cashflows are expected to steadily improve in the coming quarters and would comfortably meet the finance costs and investing cash outflows of the company over FY2022-FY2024. The company has substantial scheduled debt repayments of around Rs. 182 crore and Rs. 848 crore fall due in Q4FY2022 and FY2023 respectively. Undrawn debt of Rs. 1224 crore and liquid investments and bank balances of Rs. 150 crore, as on December 31, 2021, provides further support to the liquidity profile.

Rating sensitivities

Positive factors – Sustained improvement in net operational cash flows from the real estate and contracting division resulting in further reduction in debt levels along with increase in proportion of project specific loans. Specific credit metrics that could lead to an upgrade include net debt/FFO remaining below 3.0 times on a sustained basis.

Negative factors – The ratings could be downgraded in case if lower-than-expected pre-sales and collections increases 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 subsidiaries/associates/JVs, 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 51.99% of equity shares in the company. As on December 31, 2021, Sobha executed real estate projects with an overall development of 61.50 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 54.40 million sqft.

Key financial indicators (audited)

| Consolidated | FY2020 | FY2021 | 9MFY2022 |
|--|--------|--------|----------|
| Operating Income (Rs. crore) | 3753.8 | 2109.8 | 1999.6 |
| PAT (Rs. crore) | 281.7 | 62.3 | 91.8 |
| OPBDIT/OI (%) | 29.7% | 32.0% | 34.3% |
| PAT/OI (%) | 7.5% | 3.0% | 4.6% |
| Total Outside Liabilities/Tangible Net Worth (times) | 3.5 | 3.6 | 3.6 |
| Total Debt/OPBDIT (times) | 2.8 | 4.6 | 3.0 |
| Interest Coverage (times) | 1.6 | 1.1 | 1.2 |

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Note: Amount in Rs. crore; All calculations are as per ICRA research

Source: Company, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| Instrument | Current Rating (FY2022) | | | | Chronology of Rating History for the past 3 years | | | | |
|---------------------------------------|-------------------------|--------------------------|---|-------------------|---|-------------------------|-------------------------|-------------------|-------------------------|
| | Type | Amount Rated (Rs. crore) | Amount Outstanding as of Dec 31, 2021 (Rs. crore) | Date & Rating in | | Date & Rating in FY2021 | Date & Rating in FY2020 | | Date & Rating in FY2019 |
| | | | | 24-Mar-2022 | 11-Jun-2021 | 14-Sep-2020 | 20-Feb-2020 | 29-July-2019 | 14-Sep-2018 |
| 1 Term Loans | Long Term | 2399.40 | 2804.00 | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) |
| 2 Working Capital Facilities | Long Term | 1079.90 | | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) |
| 3 Non-fund Based Facilities | Long Term | 693.60 | NA | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) |
| 4 Proposed Non-convertible Debentures | Long Term | - | - | - | [ICRA]A+ (Stable); withdrawn | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | - | - |

Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|----------------------------|----------------------|
| Term Loans | Simple |
| Working Capital Facilities | Simple |
| Non-fund Based Facilities | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. Crore) | Current Rating and Outlook |
|---------|----------------------------|-----------------------------|-------------|---------------|--------------------------|----------------------------|
| NA | Term Loans | FY2014-FY2022 | - | FY2023-FY2034 | 2399.40 | [ICRA]A+ (Stable) |
| NA | Working Capital Facilities | - | - | - | 1079.90 | [ICRA]A+ (Stable) |
| NA | Non-fund Based Facilities | - | - | - | 693.60 | [ICRA]A+ (Stable) |

Source: Company

Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|--|-----------|------------------------|
| Annalakshmi Land Developers Pvt Ltd | 100.00% | Full Consolidation |
| 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 |
| Sobha Highrise Ventures Private Limited | 100.00% | Full Consolidation |
| Sobha Interiors Private Limited | 100.00% | Full Consolidation |
| Sobha Nandambakkam Developers Limited | 100.00% | Full Consolidation |
| Sobha Tambaram Developers Limited | 100.00% | Full Consolidation |
| Sobha Construction Products Pvt Ltd | 100.00% | Full Consolidation |
| Kilai Builders Private Limited | 100.00% | Full Consolidation |
| Kuthavakkam Builders Private Limited | 100.00% | Full Consolidation |
| Kuthavakkam Realtors Private 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 |
| Valasai Vettikadu Realtors Private Limited | 100.00% | Full Consolidation |
| Kondhwa Projects LLP | 50% | Equity Method |

Source: Company annual report FY2021

Note: ICRA has taken a consolidated view of the parent (Sobha Limited), its subsidiaries/associates/joint-ventures while assigning the ratings.

ANALYST CONTACTS

Rajeshwar Burla
+91 40 4067 6527
rajeshwar.burla@icraindia.com

Mathew Kurian Eranat
+91 80 4332 6415
mathew.eranat@icraindia.com

Ritika Periwal
+91 80 4332 6412
ritika.mundhra@icraindia.com

Ishan Luthra
+91 80 4332 6419
ishan.luthra@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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