June 27, 2023

Sobha Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based TL	2399.4	2500.5	[ICRA]A+ (Stable); reaffirmed
Long-term – Fund-based/ CC	1079.9	915.0	[ICRA]A+ (Stable); reaffirmed
Long-term – Non-fund based	693.6	630.0	[ICRA]A+ (Stable); reaffirmed
Total	**4172.90**	**4045.5**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for Sobha Limited (Sobha) factors in the healthy performance of the residential real estate segment in FY2023, which is expected to sustain in FY2024. The company has reported a strong operating performance as reflected in healthy growth in sales, collections and cash flow from operations (CFO). It sold 5.65 million square feet (msf, YoY growth of 15%) of area and reported pre-sales and collections of Rs. 4,231 crore (YoY growth of 29%) and Rs. 3,588 crore (YoY growth of 44%) respectively in FY2023. Aided by healthy cash inflows from the real estate segment, the net debt reduced by Rs. 697 crore to Rs. 1,640 crore as on March 31, 2023 and is estimated to be maintained at similar levels in FY2024. Consequently, the company's leverage, net debt/CFO, improved to 1.4 times as on March 31, 2023 from 2.5 times as on March 31, 2022 and is expected to remain in the range of 1.6 to 1.7 times as on March 31, 2024. Its investments in land are likely to remain in the range of Rs. 350-500 crore annually for the next three years. The cash flow adequacy cover is healthy with receivables/ (pending construction cost + debt outstanding) of 79% as on March 31, 2023. Sobha is expected to maintain the growth trajectory in FY2024 on the back of its healthy launch pipeline with estimated sales area of 6 msf and increase in pre-sales by around 20% in FY2024. The collections are projected to improve by 25% YoY in FY2024. The rating further draws comfort from the contracting segment's adequate order book position of Rs. 1,181.5 crore as on March 31, 2023 and the company'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 also takes into account the company's established position in the Bengaluru real estate market with strong in-house project execution capabilities in the real estate and contracting sectors.

The rating is, however, constrained by the exposure to execution and market risks arising from the company's large expansion plans with estimated launch pipeline of 7-9 msf of area annually over the next two years. It is exposed to market risk for the unsold area of 7.33 msf including completed project and ongoing projects. The rating takes note of the weak operating profitability in the contracts division, which remains a drag for the company. This segment is expected to witness a breakeven OPBDITA in FY2024 and an improvement in profitability is likely only from FY2025 onwards. The operating profit margin for the real estate segment was also impacted in FY2023 on account of higher input costs. The debt levels have historically been high compared to the net working capital gap for its ongoing project portfolio due to the investment in land bank made earlier. Consequently, the company's debt/net working capital [1]remains on a higher side (1.17 times as on March 31, 2023 against 1.06 times as on March 31, 2022) and improvement in the same would be a key monitorable. Further, the rating is constrained by the cyclicality risk inherent in the real estate business, geographical concentration risk with significant dependence on

[1] *Debt to Net Working Capital (excluding land assets) indicates the cost incurred on the projects to the extent not financed by customer advances.*

Bengaluru micro-market for its completed, ongoing as well as future projects. However, the risk is mitigated to an extent with inventory in projects across various cities along with future launches in geographies such Gurugram, Kochi, GIFY City and Trivandrum.

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 various micro markets and geographies.

Key rating drivers and their description

Credit strengths

Established brand and market position – Sobha has a track record of over 29 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 70.3 msf, and contractual projects, measuring 57.3 msf, as on March 31, 2023.

Healthy pre-sales and collections in FY2023; growth expected to be sustained in FY2024 – The company continued to witness strong pre-sales and collections in FY2023, supported by healthy demand and good saleability in the ongoing projects. It sold 5.65 msf (YoY growth of 15%) of area and reported pre-sales and collections of Rs. 4,231 crore (YoY growth of 29%) and Rs. 3,588 crore (YoY growth of 44%) in FY2023 respectively. Sobha is expected to maintain the growth trajectory in FY2024 with estimated sale area of 6 msf, increase in pre-sales by around 20% and collections by around 25% in FY2024. The company continues to maintain low completed inventory stock (0.08 msf as on FY2023), which coupled with healthy pre-sales in majority of the projects, demonstrates healthy saleability. Its cash flow adequacy cover is healthy with receivables/ (pending construction cost + debt outstanding) of 79% as on March 31, 2023.

Reduction in debt levels supported by healthy cash flow from operations (CFO) – Aided by healthy cash inflows from the real estate segment and limited land/capex investments, the company's net debt reduced by Rs. 697 crore to Rs. 1,640 crore as on March 31, 2023 from Rs. 2,337 crore as on March 31, 2022 and are expected to be maintained at similar levels in FY2024. Consequently, the net debt/CFO improved to 1.4 times as on March 31,2023 from 2.5 times as on March 31, 2022 and is estimated to remain in the range of 1.6 to 1.7 times as on March 31, 2024. Nonetheless, the debt levels have historically been high compared to the net working capital gap for its ongoing project portfolio due to the investment in land bank made earlier. Consequently, Sobha's debt/net working capital remains on a higher side (1.17 times as on March 31, 2023 against 1.06 times as on March 31,2022) and improvement in the same would be a key monitorable.

Credit challenges

Exposure to execution and market risks; muted profitability for contracts division – Sobha has significant plans of expanding its ongoing portfolio to maintain the growth momentum and strengthen its market presence. The company plans to launch 7-9 msf annually over the coming two years exposing it to execution and market risks. However, ICRA takes comfort from Sobha's track record of project execution and sales. It is further exposed to market risk for the unsold area of 7.33 msf of completed and ongoing projects. The rating takes note of the weak operating profitability in the contracts division, which remains a drag for the company. This segment is expected to witness a breakeven OPBDITA in FY2024 and an improvement in profitability is likely only from FY2025 onwards. The operating profit margin for the real estate segment was also impacted in FY2023 on account of higher input costs.

Geographical and project concentration risks – The company has high geographical concentration as around 69% of the sales by volume came from the Bengaluru real estate market in FY2023. Any slowdown in sales in Bengaluru market could adversely impact its sales and collections. However, with presence of inventory in projects across various cities along with future of 13.3 msf of residential launches (as on March 31, 2023) in the coming quarters across geographies such Gurugram, Kochi, GIFY City and Trivandrum, the risk is mitigated to an extent.

Cyclicality inherent in real estate sector – Being a cyclical industry, the real estate business is highly dependent on macro-economic factors, which renders the company's sales vulnerable to any downturn in demand.

Environmental and social risks

The real estate segment is exposed to risks of increasing environmental norms impacting operating costs, including higher cost of compliance with pollution control regulations. Environmental clearances are required for commencement of projects and lack of timely approvals can affect its business operations. Impact of the changing environmental regulations on licences taken for property development could create credit risks.

In terms of social risks, the trend post-pandemic has been favourable to residential real estate developers as demand for quality home with good social infrastructure has increased. Further, rapid urbanisation and a high proportion of workforce population (aged 25-44 years) will support long-term demand for the real estate sector in India.

Liquidity position: Adequate

Sobha's liquidity is adequate as reflected by healthy cash flow from operations, available cash balances and undrawn limits. As of March 2023, the company has unencumbered cash balance of ~Rs. 315 crore. Its operating cash flows are expected to remain sufficient to meet its debt servicing obligations in FY2024. The undrawn term loans and working capital limits stood at ~Rs. 1,240 crore, as on March 31, 2023.

Rating sensitivities

Positive factors – The rating may be upgraded in case of significant and sustained growth in sales and collections in the company's real estate portfolio, and improvement in profitability in contract business, resulting in healthy growth in cash flows from operations, liquidity, and reduction in debt levels. Specific credit metrics that could lead to an upgrade include Total debt/NWC remaining below 0.8 times on a sustained basis.

Negative factors – Any significant weakening in sales velocity and collections in the ongoing and new projects and/or significant debt-funded investments in new projects resulting in deterioration in the leverage and coverage metrics, on a sustained basis, may trigger a rating downgrade.

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 consolidated the financials 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 (Sobha) is an established player in real estate development and contract construction in Bengaluru. Sobha was promoted by its chairman emeritus Mr. PNC Menon, who started his India operations after successfully running interior decoration firms in Muscat. Along with his family members, he holds around 52% of equity shares in the company.

As on March 31, 2023, Sobha has completed 191 real estate projects with an overall development of 70.34 msf 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. Sobha is currently executing 68 ongoing projects of 30.60 msf across 11 cities. In the contracting segment, Sobha has completed 337 projects in several states in India, covering a total built-up area of 57.66 msf and has 8 ongoing projects of total built-up area of 5.24 msf.

Key financial indicators (audited)

Consolidated	FY2022	FY2023
Operating income	2,561.3	3,310.1
PAT	173.2	104.2
OPBDIT/OI	20.8%	11.2%
PAT/OI	6.8%	3.1%
Total outside liabilities/Tangible net worth (times)	3.7	4.0
Total debt/OPBDIT (times)	4.7	5.5
Interest coverage (times)	1.7	1.5

Source: Company financials, ICRA Research; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore; all ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on March 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021
					Jun 27, 2023	-	Mar 24, 2022	Jun 11, 2021	Sep 14, 2020
1	Term loans	Long term	2500.5	1372	[ICRA]A+ (Stable)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)
2	Working capital facilities	Long term	915.0	632	[ICRA]A+ (Stable)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)
3	Non-fund based facilities	Long term	630.0	425	[ICRA]A+ (Stable)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)
4	Proposed non-convertible	Long term	-	-	-	-	-	[ICRA]A+ (Stable); withdrawn	[ICRA]A+ (Negative)

debentures	

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 analysing 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 are available on ICRA's website: [Click Here]

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans	FY2014-FY2023	-	FY2023-FY2034	2500.5	[ICRA]A+ (Stable)
NA	Working capital facilities	-	-	-	915.0	[ICRA]A+ (Stable)
NA	Non-fund based facilities	-	-	-	630.0	[ICRA]A+ (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Shoba's Ownership	Consolidation Approach
Parent		
Sobha Limited		Parent company
Subsidiaries		
Sobha City ['Partnership firm']	100.00%	Full Consolidation
Sobha Contracting Private 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 Private Limited	100.00%	Full Consolidation
Kilai Builders Pvt Ltd	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
Joint ventures		
Kondhwa Projects LLP	50.00%	Equity Method

Source: Company

ANALYST CONTACTS

Rajeshwar Burla
+91 40 4547 4829
rajeshwar.burla@icraindia.com

Anupama Reddy
+91 40 4547 4829
anupama.reddy@icraindia.com

Tushar Bharambe
+91 22 6169 3347
tushar.bharambe@icraindia.com

Pulkit K Varshney
+91 80 432 6427
pulkit.varshney@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

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches