

September 30, 2024

Sobha Limited: Ratings upgraded to [ICRA]AA- (Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – Term loan	2,500.50	1,611.70	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
Long-term fund-based – Cash credit	915.00	750.00	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
Long-term non-fund based limits	630.00	580.00	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
Total	4,045.50	2,941.70	

*Instrument details are provided in Annexure-I

Rationale

The rating upgrade factors in Sobha Limited's (Sobha) healthy operating performance in the residential real estate segment in FY2024, estimated strong growth in collections and cash flow from operations in FY2025, which along with the recent equity raise via rights issue is expected to result in reduction in leverage and improvement in liquidity. Sobha's pre-sales grew by ~28% to Rs. 5,415 crore and collections increased by ~17% to Rs. 5,034 crore in FY2024. ICRA expects the collections to rise by ~25-30% in FY2025, supported by healthy sales velocity and construction progress in the ongoing projects, strong launch pipeline and healthy end-user demand. Consequently, the cash flow from operations (CFO) are likely to improve.

In July 2024, Sobha has raised funds through rights issue for Rs. 2,000 crore, of which Rs. 1,000 crore has been called and the remaining is expected to be called by February 2025. Around ~60% of the rights issue is likely to be used for debt reduction, which coupled with an increase in CFO is expected to improve the Total Debt/CFO to 1.0-1.1 times in FY2025 (PY: 1.56 times). The cash flow adequacy cover is healthy with committed receivables/(pending construction cost + debt outstanding) at ~87% as of March 2024. The 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 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 ~19 msf over the next two years. It is further exposed to market risk for the unsold area of ~7.6 million square feet (msf) of space in the completed and ongoing projects. However, ICRA takes comfort from Sobha's track record of project execution and sales. The rating notes the modest profitability (profit before interest and tax) in the contracts division over the last 2-3 years. While there is an improvement in the profitability of the contracts and manufacturing division in FY2024, it remains at moderate levels with PBIT margin of around ~10%. The profitability of the real estate segment was also impacted in FY2024 by cost overruns in few projects. Further, 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 (excluding lease rental discounting (LRD) debt and contractual segment debt)/net working capital¹ remains high. However, with the reduction in debt post rights issue, this is likely to improve. Further, the rating is constrained by the cyclical risk inherent in the real estate business, geographical concentration risk with significant dependence on Bengaluru market (~52% of FY2024 sales) for its completed, ongoing as well as future projects. However, the risk is mitigated to an extent with future launches in geographies such as Gurgaon, Kochi, GIFT City and Trivandrum.

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

The Stable outlook on the [ICRA]AA- rating reflects ICRA's opinion that the credit profile of Sobha will remain aided by the company's established brand recall in the real estate market, strong marketability supporting healthy collections, strong liquidity and comfortable cash flow from operations.

Key rating drivers and their description

Credit strengths

Estimated strong growth in collections and cash flow from operations in FY2025 – Sobha's pre-sales grew by ~28% to Rs. 5,415 crore and collections increased by ~17% to Rs. 5,034 crore in FY2024. ICRA expects the collections to rise by ~25-30% in FY2025, supported by healthy sales velocity and construction progress in the ongoing projects, strong launch pipeline and healthy end-user demand. Consequently, the cash flow from operations (CFO) are expected to improve. The company maintained low completed inventory stock of ~0.2 msf as of June 2024, which, coupled with healthy pre-sales in majority of the projects, demonstrates healthy saleability. As of March 2024, the cash flow adequacy cover is healthy with committed receivables/(pending construction cost + debt outstanding) at ~87%.

Recent right issue to support in debt reduction and strengthen liquidity – In July 2024, Sobha has raised funds through rights issue for Rs. 2,000 crore, of which Rs. 1,000 crore has been called and the remaining is expected to be called by February 2025. Around ~60% of the rights issue is likely to be used for debt reduction, which coupled with an increase in CFO is expected to improve the Total Debt/ CFO to 1.0-1.1 times in FY2025 (PY: 1.56 times). 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 (excluding lease rental discounting (LRD) debt and contractual segment debt)/net working capital remains high. However, with reduction in debt post rights issue, this is likely to improve.

Established brand and market position – Sobha has a track record of over three decades in the real estate market. The company has strong in-house project execution capabilities demonstrated through completion of real estate projects with total development measuring ~77 msf, as of March 2024. As on June 30, 2024, it has developed 137.68 msf of real estate and contractual projects both inclusive, with 41.25 msf of area under development.

Credit challenges

Exposure to execution and market risks; moderate profitability for contracts division – Sobha's large expansion plans with an estimated launch pipeline of ~19 msf over the next two years exposes it to execution and market risks. It is further exposed to market risk for the unsold area of ~7.6 msf of completed and ongoing projects. However, ICRA takes comfort from Sobha's track record of project execution and sales. The rating takes note of the modest profitability (profit before interest and tax) in the contracts division over the last 2-3 years. While there has been an improvement in the profitability of the contracts and manufacturing division in FY2024, it remains at moderate levels with PBIT margin of around ~10%.

Geographical concentration risks – The company's dependence on the Bengaluru market (~52% of FY2024 sales) remains high, which exposes it to any region-specific downturn in demand. Moreover, of the total launches planned in for FY2025-FY2026 (~19 msf), the area planned to be launched in Bengaluru is ~60%, followed by Gurgaon at ~25% and Kerala at ~10%. While it plans to launch multiple projects in various cities outside Bengaluru, the extent of scale-up in these territories and their contribution to the consolidated sales mix will remain a key monitorable.

Cyclicality inherent in real estate sector – The company is vulnerable to the inherent risks in the real estate sector. Being a cyclical industry, the sector is highly dependent on macroeconomic factors, which exposes its sales to any downturn in demand.

Environmental and social risk

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. The 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 the long-term demand for the real estate sector in India.

Liquidity position: Strong

Sobha's liquidity is **strong** as reflected by healthy cash flow from operations and available free cash and liquid investment (post equity raise through right issue) as on July 30, 2024. As of March 2024, the company has unencumbered cash balance of ~Rs. 626 crore (against Rs. 280 crore as of March 2023). Its cash flow from operations are expected to remain sufficient to meet its scheduled debt servicing obligations for FY2025 and FY2026. The undrawn bank limits stood at ~Rs. 876 crore, as of June 2024.

Rating sensitivities

Positive factors – The rating may be upgraded if significant and sustained growth in sales and collections in the company's real estate portfolio, along with greater business diversification, and improvement in profitability in the contract business result in healthy growth in cash flows from operations and improvement in debt protection metrics 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. Specific trigger which may result in a rating downgrade includes total debt to cash flow from operations, at the consolidated level, remaining above 2.5 times on a consistent basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Realty – Commercial/Residential/Retail
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.

* Details are provided in Annexure-II

About the company

Incorporated in August 1995, 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. The promoter group holds 52.77% of equity shares of the company as on July 11, 2024.

Sobha, as of March 2024, has completed 206 real estate projects (191 completed as of March 2023) with an overall development of 77.10 msf of built-up area (70.34 msf as of March 2023) and it is executing 69 ongoing projects of 34.33 msf (30.6 msf as of March 2023) across 11 cities. Sobha has major presence in Bengaluru and also has diversified to other cities such as Gurgaon, Chennai, and others.

Key financial indicators (audited)

Sobha Consolidated	FY2023	FY2024
Operating income	3,303.8	3,089.8
PAT	104.2	49.1
OPBDIT/OI	11.2%	8.8%
PAT/OI	3.2%	1.6%
Total outside liabilities/Tangible net worth (times)	4.0	4.4
Total debt/OPBDIT (times)	5.8	7.3
Interest coverage (times)	1.5	1.1

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instruments	Current (FY2025)				Chronology of rating history for the past 3 years					
	Type	Amount Rated (Rs Crore)	FY2025		FY2024		FY2023		FY2022	
			Date	Rating	Date	Rating	Date	Rating	Date	Rating
Fund-based – Term loans	Long Term	1,611.70	September 30, 2024	[ICRA]AA-(Stable)	June 27, 2023	[ICRA]A+(Stable)	-	-	March 24, 2022	[ICRA]A+(Stable)
			-	-	-	-	-	-	June 11, 2021	[ICRA]A+(Stable)
Fund-based – Cash credit	Long Term	750.00	September 30, 2024	[ICRA]AA-(Stable)	June 27, 2023	[ICRA]A+(Stable)	-	-	March 24, 2022	[ICRA]A+(Stable)
			-	-	-	-	-	-	June 11, 2021	[ICRA]A+(Stable)
Non-fund based limits	Long Term	580.00	September 30, 2024	[ICRA]AA-(Stable)	June 27, 2023	[ICRA]A+(Stable)	-	-	March 24, 2022	[ICRA]A+(Stable)
			-	-	-	-	-	-	June 11, 2021	[ICRA]A+(Stable)
Proposed non-convertible debentures	Long Term	-	-	-	-	-	-	-	June 11, 2021	[ICRA]A+(Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term loans	Simple
Long-term fund-based – Cash credit	Simple
Long-term – Non-fund based limits	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	Fund-based – Term loans	FY2014-FY2024	NA	FY2023-FY2034	1,611.70	[ICRA]AA- (Stable)
NA	Fund-based – Cash credit	NA	NA	NA	750.00	[ICRA]AA- (Stable)
NA	Non-fund based limits	NA	NA	NA	580.00	[ICRA]AA- (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Sobha's Ownership	Consolidation Approach
Parent		
Sobha Limited		Parent Company
Subsidiary		
Sobha Developers (Pune) Limited	100%	Full Consolidation
Sobha Highrise Ventures Private Limited	100%	Full Consolidation
Sobha Assets Private Limited	100%	Full Consolidation
Sobha Tambaram Developers Limited	100%	Full Consolidation
Sobha Nandambakkam Developers Limited	100%	Full Consolidation
Sobha Construction Products Private Limited	100%	Full Consolidation
Sobha City ['Partnership firm']	100%	Full Consolidation
CVS Tech Park Private Limited (effective 14 Feb 2024, until which Associate)	100%	Full Consolidation
Step-down Subsidiary		
Sobha Contracting Private Limited	100%	Full Consolidation
Kilai Builders Private Limited	100%	Full Consolidation
Sobha Interiors Private Limited	100%	Full Consolidation
Kuthavakkam Builders Private Limited	100%	Full Consolidation
Kuthavakkam Realtors Private Limited	100%	Full Consolidation
Valasai Vettikadu Realtors Private Limited	100%	Full Consolidation
Vayaloor Properties Private Limited	100%	Full Consolidation
Vayaloor Realtors Private Limited	100%	Full Consolidation
Vayaloor Real Estate Private Limited	100%	Full Consolidation
Vayaloor Developers Private Limited	100%	Full Consolidation
Vayaloor Builders Private Limited	100%	Full Consolidation
Joint Venture		
Kondhwa Projects LLP	100%	Full Consolidation

Source: Company Data; ICRA Research

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About ICRA Limited:

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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.

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