August 10, 2022

Hafele India Private Limited: Ratings upgraded; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/Short-term; Fund based/Non-fund Based	332.0	322.0	[ICRA]AA- (Stable) /[ICRA]A1+; upgraded from [ICRA]A+ (Positive) /[ICRA]A1 and outlook revised to Stable from Positive
Long-term/Short-term; unallocated	-	10.0	[ICRA]AA- (Stable) /[ICRA]A1+; upgraded from [ICRA]A+ (Positive) /[ICRA]A1 and outlook revised to Stable from Positive
Total	**332.0**	**332.0**	

**Instrument details are provided in Annexure-1*

Rationale

The rating revision factors in Hafele India Private Limited's (HIPL) significant improvement in top line in CY2021, given the sharp recovery aided by strong demand and favourable demand outlook given the growing premiumization and brand awareness in the kitchen/furniture fittings business. The rating revision also factors in the company's consistent and steady improvement in financial metrics as reflected by the strengthening of its coverage indicators and liquidity position. The growth trend continues in CY2022 as reflected by 34% growth in HIPL's revenues to Rs. 560.9 crore (provisional) in H1 CY2022, compared to H1 CY2021. The operating margins for CY2021 rose to 13.9% from 8.0% in CY2020, driven by higher top line as well as part continuation of the pandemic-induced cost rationalisations. Going forward, with the situation normalising, the company is likely to scale back any Covid-related cost curtailments, which is likely to moderate the margins from CY2021 levels as reflected by margins of 11.5% in H1 CY2022. However, the operating margins are still expected to be at healthy levels and will remain a key monitorable from a rating perspective. Judicious working capital management through efficient receivables collection and strong demand conditions supporting faster inventory turnaround helped the company to improve its working capital cycle as the working capital intensity (net working capital as a percentage of operating income, NWC/OI) improved to 19% in CY2021 from 31% in CY2020. This in turn led to lower working capital borrowing levels, strengthening the capitalisation and coverage metrics. The ratings continue to derive comfort from the established position of HIPL's German promoter group, Hafele Holding GmBH (HHG), as well as its strong global brand presence in the premium architectural hardware and kitchen/furniture fittings industry. The ratings also derive strength from the professional management as well as the operational expertise and financial flexibility enjoyed by HIPL from its strong parentage. The ratings favourably factor in HIPL's strong distribution network of dealers and exclusive franchisees.

The ratings, however, remain constrained by the stiff competition in the industry and the investments required to support the increased scale of operations that are likely to keep the operating profit margins (OPM) range-bound. The ratings also remained constrained by the working capital-intensive nature of the business, driven by high inventory requirements. Moreover, there is a need to continuously invest in marketing initiatives for customer acquisition and retention. As around 75% of HIPL's (traded) products are imported, its OPM remains exposed to the fluctuations in foreign currency rates; although these are mainly mitigated by hedging through forward contracts. Further, the gross margin remains vulnerable to rupee depreciation, though it attempts to pass it on to its customers through periodic price increases. ICRA draws comfort from HIPL's established relationship with the Hafele Group worldwide.

The Stable outlook reflects ICRA's expectation that HIPL will continue to maintain its strong brand position in the fittings industry, which is expected to support its scale of operations, a strong liquidity profile and its healthy financial profile.

Key rating drivers and their description

Credit strengths

Strong brand presence in premium architectural hardware and furniture fittings; operational expertise and financial flexibility from strong parentage – HIPL is a wholly-owned subsidiary of the German firm, HHG, one of the leading players in architectural hardware and kitchen/furniture fittings segment, with a presence across six continents through 37 subsidiaries. HIPL enjoys access to the diversified product offering of HHG worldwide and enjoys a strong brand image in the premium segment. Its product range is considerably diversified vis-à-vis the competing brands. Besides operational expertise, the company benefits from the strong financial flexibility because of its parentage.

Significant improvement in operating performance in CY2021; trend expected to continue in CY2022 – The company's revenues have improved significantly with the top line at Rs. 1012.8 crore in CY2021 against Rs. 605.4 crore in CY2020, driven by strong demand. Further, the trend is expected to continue in CY2022 driven by favourable demand outlook and the same is reflected by company's revenues of Rs. 560.9 crore (on provisional basis) in H1 CY2022, which reflects a growth of 34% over the same period last year. The operating margins also improved to 13.9% in CY2021 against 8.0% in CY2020 owing to the higher top line as well as part continuation of Covid-induced cost rationalisations. Although the margins are expected to moderate in CY2022 as the company is likely to scale back any Covid-related cost curtailments, they are expected to remain healthy as reflected by operating margins of 11.4% in H1 CY2022 and will remain a key monitorable. The improvement in the top line and margins and better receivables management during CY2021 and H1 CY2022 have ensured a healthy cash flow generation, leading to limited borrowing levels and notable improvement in the debt metrics.

Strong distribution network of dealers and exclusive franchisees – HIPL has a network of more than 500 dealers and exclusive distributors across India. The distributors further supply to sub-dealers, who primarily cater to the refurbishment market for products such as hinges and door handles. The franchisee network comprises 120 exclusive franchisees across India.

Healthy medium-term demand prospects – The aspirational consumption patterns of the upper-middle income groups and HNIs augur well for its demand prospects over the medium term for HIPL, given the growing premiumization and brand aware ness in the kitchen/furniture fittings business. HIPL undertakes several initiatives to promote its brand presence, which has further improved secondary sales. The company has 11 design centres—two each in Mumbai and Chennai, and one each in Kolkata, Pune, Bengaluru, New Delhi, Hyderabad, Dhaka (Bangladesh) and Colombo (Sri Lanka)—for customers to experience the functionality of the brand's products.

Credit challenges

Working capital-intensive nature of operations – The company's business remained working capital intensive owing to its large inventory requirements. It deals in more than 8,000 active stock keeping units (SKUs), most of which are imported. The high lead time necessitates large inventory holding. However, strong demand conditions leading to faster inventory turnaround along with tighter receivable management helped the company to improve its working capital cycle as reflected in an improvement in NWC/OI to 19% in CY2021 and 20% in H1 CY2022 over 31% in CY2020. This in turn led to lower working capital borrowing levels, strengthening the capitalisation and coverage metrics. Hence, going forward, a judicious management of the inventory and receivables to keep the working capital borrowing levels under check will remain a key monitorable.

High competitive intensity and investments to support scale of operations keep operating margins range-bound – The architectural hardware and furniture fittings industry is highly fragmented with several organised and unorganised players in the field. HIPL's OPM has remained moderate and range-bound between 8.0% and 10.5% during the past four years ended CY2020, barring CY2021, owing to stiff competition in the industry and the investments undertaken (towards employees, sales, marketing and distribution activities) to support its increased scale of operations. The margin expanded to 13.9% in CY2021 owing to higher top line as well as part continuation of pandemic-induced cost rationalisations. However, with businesses returning to normal, the margin for H1 CY2022 scaled back to 11.4%.

Margins remain vulnerable to movement in input prices, along with forex fluctuations – As around 75% of HIPL's (traded) products are imported and mainly sold in the domestic market, its margins are exposed to fluctuations in foreign currency rates. However, these are primarily mitigated by hedging through forward contracts. Further, its gross margin remains vulnerable to rupee depreciation and fluctuation in input prices, though HIPL attempts to pass it on to its customers through periodic revision in prices.

Business vulnerable to overall economic environment – HIPL's business remains vulnerable to the overall economic environment as reflected in the past due to Covid-19 related disruptions. This is also underpinned by the discretionary nature of its product offering and the relatively premium segment it caters to.

Liquidity position: Strong

The company's liquidity position is strong as reflected by a healthy cash flow from operations, unutilised limits of ~Rs. 268.0 crore as on June 2022 and unencumbered cash and liquid investments of Rs. 65.0 crore as on June 30, 2022. Against this, the company has limited long-term debt repayments and is expected to incur minimal capex, supporting its liquidity position in the near to medium term. With growing business and profitability, the dividend pay-out ratio is also expected to go up from CY2022. However, given the flexibility available in terms of managing the pay-outs as per investment and business requirements in the Indian entity, the liquidity is expected to remain at comfortable levels as earlier.

Rating Sensitivities

Positive factors – The rating may be upgraded if there is significant improvement in the scale of operations through better product diversification coupled with the ability to maintain operating margins and the healthy liquidity position on a sustained basis.

Negative factors – Pressure could arise on the ratings if there is a material weakening in the company's revenues, profit margins and elongation of working capital cycle, which impacts its overall financial/liquidity profile. Sustained deterioration of operating margins below 9.0% will remain a negative rating trigger. Weakening of the company's linkages with its parent company or weakening in credit profile of the parent entity may also impact the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

HIPL, incorporated in 2003, is a 100% subsidiary of the German firm, HHG. While HIPL originally dealt in kitchen/furniture fittings and the architectural hardware product line of HHG, over the last four years, it has diversified into segments such as glass and sanitary fittings, sliding fittings, built-in appliances, lighting systems and kitchen slabs, among others.

HIPL has a product range of over 1,50,000 articles, which are either supplied under the in-house brand range or through other suppliers. The in-house brand range comprises nine brands, including Nagold (appliances), Ixconnect (connectors), Moovit (runner systems), Slido (sliding door solutions), Dialock (electronic locking and access control systems), Loox (lighting series), Officys (furniture fittings for offices) and EPC (customised client solutions). These products are assembled globally at Hafele

Germany and Hafele China before being supplied to various subsidiaries. HIPL deals in brands of over 1,500 suppliers such as BLUM (Austria), Bertazonni (Italy), and Blanco (Germany). The company is present in Sri Lanka, Bhutan, Bangladesh and Nepal.

Key financial indicators

	CY2020	CY2021
Operating income (Rs. crore)	605.4	1,012.8
PAT (Rs. crore)	16.7	100.9
OPBDIT/OI	8.0%	13.9%
PAT/OI	2.8%	10.0%
Total outside liabilities/Tangible net worth (times)	0.8	0.7
Total debt/OPBDIT (times)	1.1	0.0
Interest coverage (times)	4.4	54.4

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

	Instrument	Current rating (FY2023)				Chronology of Rating History for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020	
					Aug 10, 2022	14-Dec-2021	1-Oct-2020	26-Aug-19	31-May-19
1	Fund-based Limits	Long-term/ Short-term	0.0	-	-	-	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**
2	Fund-based / Non-fund Based Limits	Long-term/ Short-term	322.0	-	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]A+ (Positive)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**
3	Fund-based Limits	Short-term	0.0	-	-	-	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A1**
4	Interchangeable bank facilities	Long-term/ Short-term	0.0	-	-	-	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A+ (Stable)/ [ICRA]A1**
5	Unallocated	Long-term/ Short-term	10.0	-	**[ICRA]AA- (Stable)/ [ICRA]A1+**	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/ Short-term- Fund-based / Non-fund Based Limits	Very Simple/ Simple
Long-term/ Short-term- Unallocated	Not Applicable

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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based / Non-fund Based Limits	NA	NA	NA	322.0	[ICRA]AA-(Stable)/ [ICRA]A1+
NA	Unallocated	NA	NA	NA	10.0	[ICRA]AA-(Stable)/ [ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

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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.

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