November 03, 2017

HSIL Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Commercial Paper	300.00 (enhanced from 50.00)	[ICRA]A1+ Assigned/Outstanding

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 300.00-crore[1] (enhanced from Rs. 50.00-crore) commercial paper (CP) programme of HSIL Limited (HSIL)[2].

Rationale

The rating action takes into account HSIL's operational strengths in its main business lines, namely building products and glass container. These strengths arise out of significant brand strength and an established market position in its building products business and location advantage and dominant position (in southern India) in its glass containers business. HSIL's focus on improving the product mix towards premium products is a key differentiator in the building-products business. Within the packaging-products business, performance of container-glass business has been supported by stable prices, raw material and fuel costs in the last two years (rise in power and fuel costs have brought down the margins in packaging-products business; however, margins remain robust). Within the building-products business, the faucets business has grown at an accelerated pace ~25% in the past two years and has added to the profitability of the business.

The rating draws comfort from the strong balance sheet (with net gearing below 1 times as on March 2017) and liquidity profile of the company with adequate cushion (~29% in the last seven months) in its working capital limits. The net gearing remains low despite the capital expenditure incurred to set up manufacturing facilities for pipes and fittings, as well as security caps and closures. While the aggregate expenditure in these verticals (and other businesses) will continue to remain sizeable in FY2018 as well, the capital structure is expected to remain comfortable due to strong accruals in the main businesses of the company. Additionally, the company's term debt is long tenured and low cost, resulting in relatively low debt servicing burden for the company with interest coverage of 8.68 times in FY2017. The net profitability and return indicators were low in FY2017 (10.3%) and are expected to remain subdued in FY2018 on account of ongoing capital expenditures.

HSIL's key businesses have been impacted in the last three quarters by demonetisation, implementation of Goods and Services Tax (GST, effective July 1, 2017) and ban on the sale of liquor near National Highways. These factors have affected the growth and profitability of both the building products and packaging products businesses. However, ICRA notes that the effects of these factors are transient and with the fundamental operational and competitive strengths of the company intact, a revival in demand will significantly add to profitability.

Rating concerns emanate from the ability of the company to stabilise its new businesses of pipes and fittings as well as security caps and closures. The company being a new entrant in these businesses is exposed to competitive pressures and demand dynamics, which are different from the existing businesses.

[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

However, both the businesses are lucrative in terms of realisable operating margins and will be supported by linkages with the existing businesses of the company, its superior brand recognition and available distribution and channel linkages. Further, the phased expansion in both these businesses will enable the company to respond to demand with more agility.

Input cost pressures can impact the company's margins, particularly in the packaging products division, where the intensity of raw material as well as power and fuel expenses are relatively higher and the possibility of price hike is minimal. In addition, the profitability is likely to be limited by the consumer products and retail business in the near-to-medium term. However, these businesses constitute ~10% of the company's revenues and hence their contribution to profitability (or loss) is also lower. Going forward, the ability of the company to counter rising input cost pressures in the packaging products business, competitively capture market share in the new businesses of pipes and fittings as well as security caps and closures, and turnaround the consumer product and retail businesses will be key rating sensitivities.

Key rating drivers

Credit strengths

- **Dominant position in the building products business, diversified product profile and extensive distribution network –** HSIL is the leading player in the sanitary ware industry. Its strong brand recognition and wide distribution network are other positives. This affords considerable pricing power for its products and bargaining power with its suppliers and is reflected in the profitability of this division.
- **Demonstrated a track record of maintaining operating margins in building-products business despite stiff competition** – The building-products industry is characterised by intense competition from unorganised players in the lower end product segment and potential imports in the higher end profitable segment. HSIL primarily caters to the premium segment, which helps sustain its margins. Premium and super premium products constituted 56% of the divisions' sales in FY2017.
- **Established position in the container glass industry with locational advantage and dominant position (in southern India)** – HSIL, with 1,600 TPD capacity, is the dominant player in the container glass business in southern India. Established clientele, operating efficiencies and stability of prices have benefitted the profitability of this business.
- **Comfortable capital structure and strong liquidity profile** – Despite substantial capital expenditure in FY2017, the company's capital structure remains comfortable with a net gearing of 0.70 times as on March 31, 2017. Further, the debt-servicing requirements are relatively low on account of long tenured and low cost term debt. Also, the company has significant cushion available in its working capital limits.

Credit weaknesses

- **Building products and glass businesses remain exposed to cyclicality in respective industries** – The building-products business is exposed to the cyclical nature of the market it caters to, namely housing and construction. On the other hand, the glass business is not only exposed to the cyclicality in the user industries but also supply-induced cycles. Nonetheless, the company's focus on Tier II and Tier III cities and a higher retail presence has buffered the building-product division's operations against real estate cycles. However, the overall growth in the business has remained low.
- **Input cost pressures in the packaging-products division** – The glass business involves high incidence of raw material (primarily soda ash) as well as power and fuel costs. Thus, it remains vulnerable to increases in the same. Rising input costs, particularly when a price hike of the products may be difficult, can subdue the PBIT margins of the business from 10.3% in FY2017.

- **Subdued profitability on account of loss-making consumer products and retail businesses; demand pressures in the packaging products and building products business** – Increased marketing spend in the consumer business, absorption of losses in the retail business, change in product mix of packaging products division and increased incentives/discounts in the building products division on account of dampened demand led by demonetisation, have impacted operating margins of the company. HSIL recorded operating margins of 14.0% in FY2017 as against 16.7% in FY2016. Consumer products and retail businesses are expected to report losses in FY2018 as well.
- **Return indicators to remain moderate in the near term** – Sizeable capital expenditure incurred in FY2017 and likely to be incurred in FY2018 are expected to result in subdued return indicators for the company. The return on capital employed (ROCE) stood at 10.3% in FY2017 as against 12.9% in FY2016.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria
Corporate Credit Rating Methodology

About the company
HSIL Limited (HSIL) is promoted by Dr. RK Somany and his son, Mr. Sandip Somany. The company is involved in manufacturing and trading of sanitary ware, faucets, and consumer products such as kitchen hobs, hoods, air and water purifiers, water heater and home furniture and furnishings. In addition, the company is involved in manufacturing container glass and polyethylene terephthalate (PET) bottles. The installed capacity for sanitary ware is 4.2 million pieces per annum, for faucets is 3.0 million pieces per annum, for container glass is 1,600 tonne per day (TPD) and for PET bottles is 9650 MT per annum. HSIL's glass units are located near Hyderabad (Telangana), which is a major demand centre for consuming industries like soft drinks, food, liquor and pharmaceuticals. At present, the company is setting up manufacturing facilities for CPVC and UPVC pipes (with initial capacity of 12,000 MT) as well as security caps and closures (with initial capacity of 275 million pieces per annum) in Medak, Telangana. The facilities are expected to start commercial operations in H2 FY2018.

In FY2017, the company reported operating income (OI) of Rs. 2,066.1 crore and total comprehensive income of Rs. 105.5 crore as against OI of Rs. 1,956.0 crore and total comprehensive income of Rs. 116.3 crore in FY2016.

Key financial indicators

	FY2016	FY2017
Operating Income (Rs. crore)	1956.0	2066.1
TCI (Rs. crore)	116.3	105.5
OPBDIT/ OI (%)	16.7%	13.9%
RoCE (%)	12.9%	10.3%
Total Debt/ TNW (times) ^	0.67	0.94*
Total Debt/ OPBDIT (times)	1.91	3.22
Interest Coverage (times)	7.95	8.60
NWC/ OI (%)	31%	32%

OI: Operating Income; TCI: Total Comprehensive Income; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress – Capital Advances); NWC: Net Working Capital
^Net worth excludes Business Reconstruction Reserve of Rs 460 crore (created during FY2010 and FY2012)
**Net gearing of 0.70 times as on March 31, 2017*

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years
Table

S.No	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				November 2017	September 2017	-	-	October 2014
1	Commercial Paper	Short Term	300.00	[ICRA]A1+	[ICRA]A1+	-	-	[ICRA]A1*

'*' symbol in the table above represent rating withdrawn

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

<u>Instrument Details</u>

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Commercial Paper – Proposed	-	-	-	300.0	[ICRA]A1+

Source: HSIL

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About ICRA Limited:

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