

April 13, 2020

Somany Ceramics Limited: Rating placed under watch with negative implications

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	150.00	150.00	[ICRA]A1+@; placed under watch with negative implications (revised from Watch with developing implications)
Total	150.00	150.00	

* Instrument details provided in Annexure-1

Rationale

The rating action factors in the impact of the novel coronavirus (Covid-19) outbreak on the ceramic tiles industry with an unprecedented nationwide lock-down having disrupted production across tile manufacturers and their supply chain from March 2020 onwards. This has further worsened the already muted end user demand resulting in profitability and growth challenges for companies in FY2021. In addition, ICRA had already highlighted concerns in relation to the incident of default in payment a stockbroker¹ of Somany Ceramics Limited (SCL) as well as inter-corporate deposits (ICDs) to unrelated entities. The current scenario could result in delays in recovery of these ICDs. At present, SCL's liquidity is adequate supported by buffer available in the form of unutilised working capital limits of approximately Rs. 100 crore at the standalone level as of March 31, 2020. The company has also applied for a moratorium on debt servicing on one loan under the RBI forbearance scheme, in order to conserve liquidity. While the liquidity buffer appears adequate in light of the current cost obligations including salaries and other fixed costs, a prolonged production shutdown or significantly lower demand could deplete this buffer. Accordingly, ICRA will continue to monitor the situation as it evolves and assess its impact on the credit profile of SCL.

SCL's return metrics were impacted by a decline in margins led by lower average realisations and as well as inadequate asset utilisation in FY2019. Further, the company's revenue growth was modest in FY2019 which coupled with moderate profitability (also impacted by provisioning of loss due to employee related fraud) resulted in moderation of debt coverage indicators. In FY2020, with loss provisioning for broker default and a weaker than expected last quarter with shutdown of operations, the company's FY2020 credit metrics are estimated to further moderate in the near term in the backdrop of subdued demand.

The above concerns notwithstanding, the rating continues to draw comfort from SCL's established position in the domestic tiles market with long track record of operations in the industry, its well-recognised brand, significant

¹ On 6th September 2019, SCL had disclosed to the exchanges that a cheque of Rs. 26.2 crore issued in favor of SCL by Mentor Financial Services Pvt Ltd (Mentor), a stockbroker of the company, had bounced owing to insufficient funds. The company issued demand notices for repayment to Mentor. However, In view of continued default by Mentor, the company subsequently filed a criminal complaint

manufacturing presence and pan-India distribution reach. The company continues to be one of the largest players in the Indian tiles industry, with a sizeable scale of operations and a well-diversified customer base with presence across both retail and institutional segments. Moreover, the rating takes into account the comfortable capital structure with gearing of 0.54 times as on September 30, 2019. Further, while the competitive intensity in the industry has remained high, the recent regulatory developments such as the ban by National Green Tribunal (NGT) on captive coal gasifier plants in the Morbi region along with stricter implementation of GST/E-way bill, are expected to increase the compliance costs for unorganised players, which augurs well for the long term demand prospects of organized players like SCL.

SCL Limited did not honour its scheduled payment obligations falling due on March 31, 2020 for some of its facilities, as it is seeking a moratorium on payments from its lenders as part of the COVID-19 - Regulatory Package announced by the Reserve Bank of India (RBI) on March 27, 2020. However, despite the missed payment and despite the absence of a formal approval from the lenders allowing for a payment relief, ICRA has not recognized this instance as a Default as of now. This is based on ICRA's expectation that a formal approval for rescheduling the loan would be received soon, as permitted by the RBI as part of the relief measures announced recently. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020. It may however be noted that if the lenders do not approve of the moratorium in due course, ICRA would review the above stance on default recognition.

Key rating drivers and their description

Credit strengths

Established position in domestic tile market; well-recognized brand with pan-India presence in distribution and manufacturing - SCL is one of the leading players in the domestic tiles industry with four-decade-long track record of operations, well-recognized brand and pan-India distribution reach. The company has an established distribution network comprising around 10,000 touch points, including dealers, sub-dealers and franchisee-managed showrooms/display centres. With presence across multiple price points and products, significant distribution reach as well as brand recognition, the company has been able to maintain a healthy business position.

Healthy scale of operations with well-diversified customer base - SCL is among the largest players in the Indian tile industry, with a sizeable scale of operations (revenues of around Rs. 1,695 crore in FY2019 and Rs. 1,242 crore in 9M FY2020). The company has a well-diversified customer base with established presence across both retail and institutional segments, with retail constituting around 70% of the revenues. Within the institutional segment, the company aims to further increase its presence across corporate and Government segments to diversify its revenue profile further.

Favourable demand prospects for organised tile manufacturers amid stricter regulatory requirements - The tiles industry is characterised by significant presence of the unorganised sector, resulting in intense competition. However, the recent regulatory developments, including the ban on captive coal gasifier plants in the Morbi region by NGT in March 2019 and stricter implementation of GST/e-way bill, are expected to increase the compliance costs for unorganised players and augur well for demand prospects of organised players like SCL. Nevertheless, even as end user demand has remained muted over the last few quarters, the industry is now facing further pressure amid the Covid-19 outbreak.

Comfortable gearing level despite moderation in coverage indicators - SCL's gearing remained comfortable at 0.54 times as on September 30, 2019 (marginally higher than 0.48 times as on March 31, 2019), while the coverage indicators deteriorated to some extent in H1FY2020 on account of a decline in cash accruals. SCL's total debt/OPBDIT increased to

3.27 times as of September 30, 2019 (2.46 times as of March 31, 2019), while interest coverage stood to 4.25 times (4.41 times in FY2019). The coverage indicators are expected to moderate further in the near term, on account of expectation of subdued profits and cash accruals.

Credit challenges

Scale of operations remains rangebound - SCL's revenues declined 8% YoY in FY2018, impacted by implementation of internal enterprise resource planning solution in April 2017 as well as implementation of GST in July 2017. In order to recoup sales volumes, SCL relaxed credit terms in H2 FY2018 that resulted in an increase in receivable days to 104 days as on March 31, 2018. However, as the management targeted to control the credit period offered, the sales growth remained modest at 2% in FY2019, as the consumer demand remained weak. In 9MFY2020, the company witnessed a growth of 5.3% as compared to corresponding previous mainly led by volumes as realisations remained under pressure. However, a weak Q4FY2020 is expected to result in limited or no growth revival for the full year FY2020.

Deterioration in return metrics in past two years led by decline in operating profit margin and moderation in asset turnover - SCL's ROCE declined over the last two years following a decrease in OPM (on account of higher power and fuel costs) even as the company invested in capacity creation as well as enrichment of product mix through the JV route, besides significant advances to unrelated entities. In 9MFY2020, the company reported OPM of 5.8%, better than 5.2% in corresponding previous. However net margins were weaker at 1.2% as compared to 2.2% in corresponding previous owing to provision of broker default related loss. Going forward as well, SCL's operating profitability and return metrics remain vulnerable to increase in input costs and weak demand prospects for the real estate industry, exacerbated by delayed revival amid Covid-19 outbreak.

Increased uncertainty on recoverability of ICDs - The quantum of ICDs given to unrelated entities by SCL increased significantly to Rs. 59 crore as on March 31, 2019 from Rs. 9 crore as on March 31, 2018. This alongwith default by broker moderated SCL's liquidity. The Covid-19 outbreak has intensified liquidity and credit pressures for Indian corporates, which therefore increases uncertainties on timely recovery of the said ICDs. Going forward, strengthening of investment policies of the company, and subsequent reduction in exposures towards unrelated entities would be a key monitorable.

Highly competitive business with presence of large-sized organised players and several unorganised players - The presence of large organised players and numerous small-sized players along with the high pace of capacity additions in the recent past resulted in intense competition in the industry. This is reflected in the consistent decline in SCL's margins as well as increased collection period in FY2018. However, with stricter credit control measures implemented by the company, the collection period improved in FY2019.

Need for strengthening internal systems and processes to timely identify any operational lapses - The company reported extraordinary loss of Rs. 15.9 crore in FY2019 on account of misappropriation of funds by an employee. Although SCL has an insurance cover against the aforesaid employee fraud, such an incident raises concern on the efficacy of its internal control systems and underscores the need for strengthening the same.

Liquidity position: Adequate

SCL's liquidity position remains **Adequate** primarily supported by unutilised working capital limits of Rs. 100 crore as on March 31, 2020. In absence of any collections in the lockdown, the company can utilise this buffer over the near term to cover its fixed costs. SCL's long-term debt (Rs. 110.7 crore as on September 30, 2019) has relatively spread out annual repayments. Therefore, it will not result in increased repayment burden in any particular year.

Rating sensitivities

Positive triggers – Not applicable.

Negative triggers – Negative pressures on SCL’s rating could arise if there is a significant decline in the company’s profitability and cash accruals, which results in deterioration of coverage indicators (standalone total debt/OPBITDA exceeding 2.6x on sustained basis) or if there is any stretch in its receivables cycle leading to an increase in working capital needs and reduction in liquidity buffer (liquidity buffer including unavailed drawing power and cash and liquid investments falling below Rs. 125 crore on a sustained basis). Moreover, any sizeable investments in unrelated entities in the future and/or delay in recovery of earlier advanced loans to unrelated entities remains a key rating sensitivity. Pressures also remain if Covid related lockdown persists materially impacting the company’s earnings capability.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of SCL; Also, ICRA has considered the ongoing and expected future funding support that SCL may provide to its subsidiaries and associates in the ordinary course of business; as on March 31, 2019, SCL had 12 subsidiaries and associates that are enlisted in Annexure-2

About the company

SCL was incorporated in 1969 as a manufacturer of ceramic tiles, by Mr. H L Somany in collaboration with Pilkington’s of U.K as a widely held company. Since then it has extended production capacities as well as the product range. SCL is engaged in manufacturing, outsourcing and trading of ceramic and vitrified tiles. The two manufacturing facilities are located at Kassar in Haryana (near Delhi) and Kadi in Gujarat (near Ahmedabad) and have an aggregate capacity of 26.28 msm. In addition, through JVs and subsidiaries, the company has access to aggregate capacity of 54 msm. Further, the company has outsourced capacity of 9 msm. The company markets its tiles under the established brand names like Somany, Du-rastone, Duragress, VC Shield, Somany Express, etc. SCL has also entered into sanitaryware and bath fittings segment through JVs and outsourcing.

Key financial indicators (Audited)

Rs. Crore	FY2018	FY2019	H1 FY2020*
Operating Income (Rs. crore)	1,665.3	1,695.5	808.8
PAT (Rs. crore)	65.1	46.3	22.2
OPBDIT/OI (%)	7.9%	6.8%	6.0%
RoCE (%)	14.2%	10.9%	
Total Outside Liabilities /Tangible Network	1.28	1.18	
Total Debt/OPBDIT (times)	2.19	2.46	3.27
Interest Coverage (times)	7.48	4.41	4.25
DSCR	2.37	1.75	

*unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2021)		Date & Rating	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018	
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)*	13-Apr-2020	9-Oct-2019	30-Nov-2018	13-Oct-2017	17-Jul-2017
1 Commercial Paper	Short Term	150.00	-	[ICRA]A1+@	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

&- under watch with developing implications, * as on March 31, 2020

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: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	-	-	7-365 days	150.00	[ICRA]A1+@

Source: SCL; @- under watch with negative implications

Annexure-2: List of entities considered for possible funding support from SCL

Company Name	Ownership	Consolidation Approach
SR Continental Limited	100%	Limited Consolidation
Somany Bathware Limited	100%	Limited Consolidation
Amora Tiles Pvt Ltd	51%	Limited Consolidation
Somany Excel Vitrified Pvt Ltd	100%	Limited Consolidation
Somany Fine Vitrified Tiles Pvt Ltd	51%	Limited Consolidation
Vintage Tiles Pvt Ltd	50%	Limited Consolidation
Acer Granito Pvt Ltd	26%	Limited Consolidation
Vicon Ceramic Pvt Ltd	26%	Limited Consolidation
Somany Sanitary-ware Pvt Ltd	51%	Limited Consolidation
Sudha Somany Ceramics Pvt Ltd	60%	Limited Consolidation
Amora Ceramics Pvt Ltd	51%	Limited Consolidation
Somany Bath Fittings Pvt Ltd	51%	Limited Consolidation

Source: SCL

ANALYST CONTACTS

Sabyasachi Majumdar
+91-124-4545304
sabyasachi@icraindia.com

Anupama Arora
+91-124-4545303
anupama@icraindia.com

Sheetal Sharad
+91-124-4545374
sheetal.sharad@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

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