HSIL Ltd

November 20, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	1294.40 (enhanced from 1214.40)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Removed from credit watch; Rating Revised from CARE AA- (Double A Minus)**
Short term Bank Facilities	300.00 (enhanced from 285.00)	**CARE A1+ (A One Plus)**	**Removed from credit watch; Rating Reaffirmed**
Total Facilities	**1,594.40 (Rs. One Thousand five hundred ninety four crore and forty lakhs only)**		
Commercial Paper (CP) issue*	300	**CARE A1+ (A One Plus)**	**Removed from credit watch; Rating Reaffirmed**

Details of instruments/facilities in Annexure-1
**carved out of the sanctioned working capital limits of the company.*

Detailed Rationale & Key Rating Drivers

The ratings for the bank facilities of HSIL Ltd (HSIL) have been removed from 'Credit Watch with Developing Implications' as CARE has analyzed the impact of the declared composite scheme of demerger on the credit risk profile of HSIL and reviewed the ratings following clarity from the management with regards to the demerged businesses, their likely financial profiles and expected synergies and timelines of the same.
CARE had placed the rating on watch on November 22, 2017, following HSIL's announcement of the composite scheme of arrangement. The scheme provides for the demerger of its existing (i) Consumer products distribution & marketing Undertaking ("CPDM Undertaking") and Retail Undertaking of the company into Resulting Company 1 (*Somany Home Innovation Ltd (SHIL*)), and (ii) the Building products Distribution & Marketing Undertaking ("BPDM Undertaking") of the company into Resulting Company 2 (*Brilloca Ltd*). The scheme has already been approved by the Securities and Exchange Board of India, creditors, shareholders, lenders and stock exchanges, while the approval from the National Company Law Tribunal (NCLT) is expected to be received over next two to three months.

The rating revision for the long term bank facilities of HSIL Limited (HSIL) takes into account the moderation in the financial risk profile of the company characterized by its declining profitability margins primarily in the packaging products division (PPD) and higher than envisaged moderation in its capital structure due to the ongoing debt funded capital expenditure. The rating revision also factors in the susceptibility of HSIL's financial profile to raw material and fuel price fluctuation risk, foreign exchange fluctuation risk, and high competition in the industry. The ratings however continue to derive strength from the experience of the promoters, established track record, wide distribution network with recognized brand name in sanitary ware and established relations with institutional clients in the container glass segment. The ratings continue to factor in the HSIL's diversified presence in the building products and packaging products segments. CARE has also factored in the expansion done by HSIL in the CPVC & UPVC pipes segment and security caps & closures to complement its container glass segment for utilizing its brand franchise and distribution network more effectively.

Going forward, the ability of HSIL to successfully execute its capital expenditure projects without any cost & time overrun and derive the projected returns, maintaining its market position in the container glass segments while enhancing the overall scale of operations & profitability margins in all the segments along with maintaining a comfortable capital structure would be the key rating sensitivities.

CARE further believes that the credit risk profile of the demerged HSIL may continue to be impacted by competitive intensity, while the quantum and timeliness of synergy benefits that shall flow from the resulting companies & the support provided by the promoters will be key monitorable & rating sensitivity factors.

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Detailed description of the key rating drivers

Key Rating Weaknesses

Moderation in the financial risk profile & Capital structure: HSIL's income from operation although has increased by 9% in FY18 (refers to the period April 01 to March 31) to Rs.2,280.05 crore, the PBILDT margin has however declined to 13.78% in FY18 vis-à-vis 15.50% in FY17 mainly due to increased marketing spend in the consumer business, absorption of losses in the retail business and increased power & fuel cost for the glass busniess (PPD). The PBILDT margins have further registered a dip in H1FY19 to 10.75% from 12.53% in H1FY18 (without considering the fx gain or loss). With the international prices of crude going up, price of all the fuels whether LPG, pet coke etc have increased leading to a margin drop in the PPD which was accentuated by the lack of volume pick up in this segment, making it difficult for the company to increase the prices to pass on the increase in fuel prices. However, with pick of demand in the current financial year (FY19), some price hikes have been taken in the recent past. Nevertheless, managing the fluctuation in prices of inputs shall remain critical for the profitability of the company. Further with the ongoing debt funded capex the interest cost has increased significantly in FY18 & also in H1FY19. The rising interest cost & declining profitability has exerted pressure on the interest coverage indicators which have deteriorated from 8.54x as on March 31, 2017 to 4.89x as on March 31, 2018 & further to 3.55x as on Sep 30, 2018.

HSIL's overall gearing has increased from 0.66x as on March 31, 2017 to 0.84x as on March 31, 2018. The overall gearing is further expected to remain elevated in the medium term on account of the ongoing debt funded expansion program. The increase in gearing as on March 31, 2018 is mainly on account of high utilization of working capital limits & ongoing debt funded capital expenditure undertaken by the Company. .

Exposure to raw material cost and fuel price fluctuation: Soda ash, a major raw material for manufacturing of container glass has been the key contributor to the raw material cost. Also, power and fuel cost is another significant cost-item for the company. The company has the policy to pass-on the increase in costs to consumers either fully or partially but with a lag, depending upon the demand and the competitive scenario. The prices of the key raw material & fuel have been on the rising trend & HSIL was unable to pass on the increased cost under the sluggish demand environment primarily in the PPD segment. As discussed with the management, the Company has recently taken price hikes with the demand showing a rising trend & expects to pass the increased cost. However, the exposure to the fluctuations in the raw material prices remains a critical rating factor.

Foreign currency fluctuation risk: With limited exports relative to imports along-with foreign currency borrowings, HSIL is exposed to exchange rate fluctuation risks. Although, HSIL has a practice to hedge its forex exposure from time to time to mitigate the risk attached with foreign currency fluctuation risk. However, in the absence of natural hedge HSIL remains exposed to foreign exchange fluctuation risks. In H1FY19 company has booked a net MTM loss of ~Rs 16 Crore.

Ongoing debt funded capex: HSIL has undertaken capex pertaining to the establishment of new manufacturing facility as well expansion of existing manufacturing facility which has resulted in the moderation of the capital structure of HSIL. However, the expansion, especially in CPVC and UPVC pipes are primarily to utilize its brand franchise and distribution network more effectively, The company has also set up a manufacturing facility for the security caps and closures to complement its container glass segment. Security caps impede counterfeiting of alcoholic beverages and find use in the pharma segment as well. However, the ability of HSIL to successfully execute its capital expenditure projects without any cost & time overrun and derive the projected returns while maintaining the envisaged capital structure would be the key rating sensitivities going forward.

Competitive nature of industry: HSIL currently has a major presence in the building products (pertains to sanitary ware and faucet ware products) and container glass segments. There is a substantial shortage of housing and sanitation facilities in India, which is expected to result in steady demand for sanitary ware products. Furthermore, factors such as increasing urbanization with the government's plan to develop at least 100 smart cities, renewed focus on infrastructure growth, better demographic profile and increasing awareness towards better sanitation facilities augurs well for the industry. The sanitary ware and faucet ware industry are significantly fragmented with high contribution from the unorganized sector and established brands like 'CERA', 'Parryware' in sanitary ware, 'Jaquar' in faucet ware thus increasing competition.

Key Rating Strengths

Experienced promoters and management team: HSIL is promoted by Dr R K Somany who is the Chairman and Managing Director of the company and has an extensive experience of over 60 years in the industry. The board of the company is broad-based and has several independent professional members having vast industry experience in diverse backgrounds. The operations of the company are managed by well qualified and experienced senior management team.

Diversified business operations with wide distribution network: HSIL has well-diversified operations which include sanitary ware, CPVC and UPVC pipes, faucets, wellness and other allied products under Building Products Division (BPD), while the Packaging Products Division (PPD) includes container glass, pet bottle and security caps and closures business. Further HSIL also has Consumer Product Division (CPD) which includes Kitchen appliances, water heaters, Air Purifiers water purifiers & air coolers and Retail division which includes retail furniture, home furniture, and modular kitchen business. The company has major focus on the retail market for building products and has wide retail spread with presence in more than 50 cities across India. Also, the company has more than 550 institutional clients under the packaging division. Further in the CPD, HSIL has adopted a dual-marketing approach – the conventional organised retail channel in which they have gained 8,500 retail touchpoints and have a visible presence across 350 large format stores. This is further complemented by their presence across leading e-commerce portals to ensure their reach across all online and offline formats. As on March 31, 2018 HSIL has 30,500 retail touchpoints (Including 8,500 for CPD), 3950 trade partner network, 30 distributors & 14 large format retail stores under EVOK.

Strong brand name and established client relationship for institutional business: HSIL's sanitary-ware brand '*Hindware*' is one of the oldest and well-known brands and is the market leader in the segment. HSIL also manufactures faucets and is the third largest player in the segment. Also, under the packaging division, through container glass manufacturing, the company has a presence in liquor, food and beverages as well as pharmaceutical sectors. HSIL is the second largest player in the container glass industry in terms of revenue and capacity.

Analytical approach: Standalone.

Applicable Criteria

CARE's Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
CARE's Methodology for Short-term Instruments
CARE's Methodology for manufacturing companies
Rating Methodology: Factoring Linkages in Ratings
Criteria for placing rating on credit watch
Financial Ratios – Non Financial Sector

About the Company

HSIL (CIN: L51433WB1960PLC024539), incorporated in February 1960, was promoted by Kolkata-based Somany brothers and, currently, the management control vests with Dr R K Somany faction. HSIL currently operates majorly through four divisions, namely, Building Products (BPD; includes sanitary ware, CPVC and UPVC pipes, faucet ware and wellness items), Packaging Products (PPD; includes container glass, security caps and closures and pet bottles), Consumer Products (CPD; includes Kitchen appliances, water heaters, Air Purifiers, water purifiers & air coolers) and Retail division (Includes Retail furniture, Home furniture, and modular kitchen business vested in HSIL pursuant to the scheme of arrangement entered into by HSIL with HHRPL) with about 46% of gross sales in FY18 from BPD while PPD accounted for 41% of the gross sales in FY18, CPD and retail division contributing 9% & 4% respectively. The installed capacity for sanitary ware is 4.2 million pieces per annum, for CPVC and UPVC pipes is 12,000 MT, for faucets is 3.0 million pieces per annum, for container glass is 1,600 tonne per day (TPD), for security caps and closures is 275 million pieces per annum and for PET bottles is 9650 MT per annum. HSIL's glass units are located near Hyderabad (Telangana), which is a major demand center for consuming industries like soft drinks, food, liquor and pharmaceuticals.
The company has eleven manufacturing units spread across Haryana (sanitary-ware), Telangana (container glass, caps & closure, CPVC & UPVC pipes and sanitary-ware), Rajasthan (faucets), Karnataka (PET Bottles) and Uttarakhand (PET Bottles). The company also undertakes trading of consumer durables including Kitchen hoods and chimneys, water heaters, air purifiers, water purifiers & air coolers & trading for retail furniture, home furniture and modular kitchen.

Scheme of Demerger:

HSIL has announced a composite scheme of arrangement amongst the Company (HSIL Ltd, Demerged undertaking), Somany Home Innovation Ltd (SHIL), a wholly owned subsidiary of the residual company and Brilloca Ltd, a wholly owned subsidiary of SHIL and their respective shareholders & creditors. The scheme provides for the demerger of (i) the Consumer products distribution & marketing Undertaking ("CPDM Undertaking") and Retail Undertaking of the company into SHIL, and (ii) the Building products Distribution & Marketing Undertaking ("BPDM Undertaking") of the company into Brilloca.
Further , the manufacturing is expected to continue to remain with the demerged HSIL & consequently none of the manufacturing facilities will be shifted to any of the resulting undertaking and also the existing term debt primarily shall lie with HSIL except the debt which is pertaining to certain Moulds etc in the case of SHIL & debt pertaining to display centres & Showrooms in Brilloca Ltd shall be transferred to the respective entities and the working capital borrowings will get divided in proportion of the requirement of the respective companies (demerged & resulting undertakings).

CARE also understands & takes into account that the manufacturing and supply of packaging products referred to as "Packaging Products Manufacturing Undertaking" or "PPM Undertaking" & the entire manufacturing of all the building products & certain specified consumer products shall remain with the demerged HSIL post the scheme takes into effect.
HSIL Ltd has received the approval from BSE Limited and the National Stock Exchange of India Limited and they have also received the NOC/approval for the scheme from all the bankers & creditors of the Company and is awaiting the final nod from NCLT. The appointed date for the scheme is April 01, 2018 or such other date as will be directed by the Kolkata Bench of the National Company Law Tribunal ("NCLT").

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	2067.08	2280.05
PBILDT	284.90	272.47
PAT	105.55	74.76
Overall gearing (times)	0.66	0.84
Interest coverage (times)	8.54	4.89

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Disclaimer

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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	March 2028	694.40	CARE A+; Stable
Fund-based - LT-Cash Credit	-	-	-	600.00	CARE A+; Stable
Non-fund-based - ST-BG/LC	-	-	-	300.00	CARE A1+
Commercial Paper	-	-	7 days to 1 year	300.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	694.40	CARE A+; Stable	1)CARE AA- (Under Credit watch with Developing Implications) (04-Oct-18)	1)CARE AA- (Under Credit watch with Developing Implications) (09-Feb-18) 2)CARE AA- (Under Credit watch with Developing Implications) (21-Nov-17) 3)CARE AA-; Stable (27-Apr-17)	1)CARE AA-; Stable (09-Mar-17) 2)CARE AA-; Stable (11-Jan-17) 3)CARE AA- (07-Nov-16)	1)CARE AA- (18-Dec-15) 2)CARE A+ (09-Apr-15)
2.	Commercial Paper	ST	300.00	CARE A1+	1)CARE A1+ (Under Credit watch with Developing Implications) (04-Oct-18)	1)CARE A1+ (Under Credit watch with Developing Implications) (21-Nov-17) 2)CARE A1+ (01-Aug-17) 3)CARE A1+ (27-Apr-17)	1)CARE A1+ (09-Mar-17) 2)CARE A1+ (11-Jan-17) 3)CARE A1+ (07-Nov-16)	1)CARE A1+ (18-Dec-15) 2)CARE A1+ (01-Jul-15) 3)CARE A1+ (09-Apr-15)
3.	Fund-based - LT-Cash Credit	LT	600.00	CARE A+; Stable	1)CARE AA- (Under Credit watch with Developing Implications) (04-Oct-18)	1)CARE AA- (Under Credit watch with Developing Implications) (21-Nov-17) 2)CARE AA-; Stable (27-Apr-17)	1)CARE AA-; Stable (09-Mar-17) 2)CARE AA-; Stable (11-Jan-17) 3)CARE AA- (07-Nov-16)	1)CARE AA- (18-Dec-15) 2)CARE A+ (09-Apr-15)
4.	Non-fund-based - ST-BG/LC	ST	300.00	CARE A1+	1)CARE A1+ (Under Credit watch with Developing Implications) (04-Oct-18)	1)CARE A1+ (Under Credit watch with Developing Implications) (21-Nov-17) 2)CARE A1+ (27-Apr-17)	1)CARE A1+ (09-Mar-17) 2)CARE A1+ (11-Jan-17) 3)CARE A1+ (07-Nov-16)	1)CARE A1+ (18-Dec-15) 2)CARE A1+ (09-Apr-15)

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