Press Release

Hindustan Composites Limited

October 05, 2020

Rating Reaffirmed

Total Bank Facilities Rated*	Rs. 25.00 Cr.
Long Term Rating	ACUITE A-/ Outlook: Negative (Reaffirmed and outlook revised)
Short Term Rating	ACUITE A2+ (Reaffirmed)

** Refer Annexure for details*

Rating Rationale

Acuité has reaffirmed the long-term rating of '**ACUITE A-**' **(read as ACUITE A minus)** and the short-term rating of '**ACUITE A2+**' **(read as ACUITE A two plus)** on the Rs.25.00 crore bank facilities of Hindustan Composites Limited (HCL). The outlook is revised from **'Stable'** to **'Negative'**.

Key Reason for revision in outlook

The revision in outlook is on account of sustained pressures on the business risk profile of the company as is also reflected by a decline in its revenues over the last 6 quarters and consequent reduction in profitability levels on account of lower absorption of fixed costs. Acuité expects that such pressure will continue over the medium term due to slowdown in demand from the automotive segment. HCL has witnessed a decline in orders from OEM customers. However, the company was able to get tenders from Railway segment.

The Mumbai-based HCL, incorporated in 1964, is engaged in the development, manufacturing and marketing of brake lining using asbestos industrial products and friction material. The company is also engaged in the treasury business since 2010. HCL has two manufacturing facilities at Bhandara and Paithan (Maharashtra) with a combined capacity of 20 million units per annum. HCL entered into a joint venture (49 percent stake) with Advics North India Private Limited to set up Compo Advics (India) Private Limited. The company manufactures disc brake pads and related components for passenger vehicles.

Analytical Approach

Acuité has considered the consolidated business and financial risk profile of HCL along with its subsidiary Compo Advics (India) Private Limited to arrive at the rating. Extent of Consolidation: Full.

Key Rating Drivers

Strengths

- **Established track record of operations and experienced management**
  HCL, (formerly Hindustan Ferodo Ltd), incorporated in 1964 has been a pioneer in the development, manufacture and marketing of asbestos industrial products and friction materials for over six decades. The company is led by Mr. Raghu Mody, the Promoter and Executive Chairman, with over five decades of experience as an industrialist. He has been associated with the company since 1987. HCL started its treasury division in 2010 which now has a total portfolio of Rs.625.33 crore as on 31 March, 2020 compared to Rs.617.15 crore as on 31 March, 2019. Out of the total portfolio of Rs.625.33 crore, investment in equity instruments is Rs. 256.31 crore and the remaining in debt instruments. The company has a dedicated team of analysts and industry specialists, operating out of Mumbai and Kolkata that advises the company in its investment making decisions.

  Acuité believes that the company will be benefitted by the established track record of operation along with a healthy relationship with its customers and suppliers, which helps it to get the repeated business.

- **Healthy financial risk profile**

The financial risk profile of HCL is healthy marked by healthy net worth, low gearing and robust debt protection metrics. The net worth stood at Rs.771.32 crore as on March 31, 2020 as compared to Rs.762.82 crore as on March 31, 2019.

The company follows a conservative leverage policy as reflected by its peak gearing of 0.01times as on March 31, 2020. The total debt of Rs.5.86 crore outstanding as on 31 March, 2020 comprises Rs.0.75 crore as a secured vehicle loan from the bank, Rs.0.34 crore as unsecured loan from financial institution and Rs.4.77 crore working capital borrowings. Since the company also receives support from trade credit, its dependence on the banking system for working capital limits is moderate. The gearing is expected to remain low in future due to expectations of healthy net worth and no debt-funded capex plans.

In FY2020, net cash accruals increased to Rs.19.98 crore as against Rs.26.30 crore in FY2019. The net cash accruals have decreased on account of the decrease in net profits, particularly in manufacturing segment. However, the coverage indicators are healthy with an interest coverage ratio (ICR) of 82.83 times for FY2020 (PY: 115.63 times). The gearing (debt/equity ratio) stood healthy at 0.01 times as on 31 March, 2020. The total outside liabilities to tangible networth (TOL/TNW) stood at 0.12 times as on March 31, 2020. The net cash accruals stood healthy at Rs.19.98 crore in FY2020. Acuité expects the coverage indicators of HCL to remain healthy on account of the healthy profitability margins in the investment segment.

Acuité believes that the financial risk profile of HCL will continue to remain healthy on the back of healthy cash accruals with no major long term debt obligation.

- **Diversified client base**

  HCL (composites division) has a diversified client portfolio with top 10 clients contributing ~39 percent of the total revenue of Rs.144.40 crore in manufacturing segment for FY2020 compared to ~43 percent of total revenues of Rs.157.59 crore for FY2019. Some of the top clients include Kerala State Road Transport Corporation, Maharashtra State Road Transport Corporation and Dobac International. HCL is also a Tier 2 supplier of brake lining for Toyota. The company caters to diverse industries including railways, steel, automotive, among others.

  The non-current investment portfolio of HCL treasury division has been growing at a stable rate with Rs.596.96 crore as on 31 March, 2020 as against Rs. Rs.579.42 crore as on 31 March, 2019. In FY2020, HCL's investment portfolio included ~47 percent in quoted instruments (~46 percent in FY2019) such as bonds and government securities and the remaining in the unquoted real estate, preference shares and debentures. For current investments, the portfolio mainly consists of quoted mutual funds and quoted debentures.

  Acuité believes that HCL's investment policy of investing in less risky instruments will be instrumental in maintaining the profit margins of the company.

Weaknesses

- **Muted demand scenario**

  HCL has two streams of the revenues, revenues from the composite segment and revenues from the investment segment. The operating income from the composite segment stood at Rs. 144.90 crore for FY2020 (PY: Rs. 158.42 crore) and from investment segment stood at Rs. 33.16 crore (PY: 38.19 crore). The operating income of the company has declined in FY2020 on account of decline in revenues from the composite products, i.e. by ~14 percent from the previous year on account of weak demand in the automobile industry as well as lower treasury income due to volatile market conditions.

  The investment segment contributes to a majority of the profitability of the company as compared to the composite segment. Out of the total Profit before Interest and tax (PBIT) amounting to Rs. 24.27 crore for FY2020 (PY: Rs. 31.51 crore), the profits from investment segment was 94.50 per cent (PY: 89.69 per cent) and from composite segment, it was 5.50 per cent (PY: 10.31 per cent). Hence the ability of the company to manage its investment portfolio will be crucial to maintain the profitability over the medium term

  Further, the net profitability margins of HCL have shown a declining trend for the last four years ended 31 March, 2020. The net profitability stood at 5.88 percent in FY2020 (PY: 8.93 percent). The profitability was impacted mainly due to continuous cost pressures with volatile commodity prices. This impact could not be fully passed on to the customers because of competitive market conditions and fixed rate contracts with the Railway and other customers. Increase in international prices of Crude and other commodity prices are resulting in inflationary pressure in the company's raw material cost. The net profitability margins have also shown a declining trend.

Acuité believes that the ability of HCL to maintain its revenue streams while managing its investment portfolio mix and the profitability margins will be key rating sensitivity.

- **Working capital intensive operations**
  The working capital cycle of HCL is working capital intensive marked by GCA days of 227 days in FY2020 (PY: 209 days). The GCA days are majorly dominated by the stretched receivables which stood at 86 days as on March 31, 2020 (PY: 79 days). The inventory days are moderate and range between 25 to 30 days. The working capital cycle is further supported by stretched suppliers which moderates the working capital requirement. The suppliers are LC, backed which ranges between 60 to 90 days. The average bank limit utilisation stood at ~17 per cent for the last six months ended June, 2020.

- **Susceptibility to volatility in financial markets and economic changes and intense competition in auto component industry**
  The profitability is mainly driven by robust margins registered in the treasury business. The profitability is also susceptible to the inherent risks associated with financial markets and changes in the economy. However, HCL has a well-defined risk management policy which enables it to mitigate this risk to a certain extent. Also, the company is exposed to intense competition from organised and unorganised players. However, HCL has more than five decades of experience and has been able to establish itself in the Indian auto component industry.

Rating Sensitivity
- Significant growth in business risk profile, leading to improved operating income and profitability.
- Stretched working capital cycle and deterioration in liquidity position.

Material Covenants
None

Liquidity Position: Healthy
HCL has adequate liquidity marked by healthy net cash accruals to its maturing debt obligations. The company generated cash accruals of Rs.19.98 crore to Rs. 31.64 crore during the four years through 2017-20, while its maturing debt obligations were in the range of Rs.0.65 crore to Rs. 1.10 crore for a similar period. The cash accruals of the company are estimated to remain around Rs.19.41 crore to Rs. 21.15 crore during 2021-22 with no major debt repayment obligation. The current ratio of the company stood healthy at 2.32 times as on March 31, 2020. Acuite believes that the liquidity of the company is likely to remain healthy over the medium term on account of healthy cash accrual and no major repayments over the medium term.

Outlook: Negative
Acuité believes that the outlook of HCL will remain 'Negative' over the medium term due to the continuous decline in operating performance in the manufacturing segment. The rating may be downgraded in case of a sustained decline in the revenue profile leading to low profitability. Conversely, the outlook may be revised to 'Stable' if the company registers significant growth in revenues and profitability from the manufacturing operations.

About the Rated Entity - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Operating Income	Rs. Cr.	178.05	196.61
PAT	Rs. Cr.	10.47	17.55
PAT Margin	(%)	5.88	8.93
Total Debt/Tangible Net Worth	Times	0.01	0.00
PBDIT/Interest	Times	82.83	115.63

Status of non-cooperation with previous CRA (if applicable)
Not Applicable

Any other information
None

Applicable Criteria

- Default Recognition -https://www.acuite.in/view-rating-criteria-52.htm
- Manufacturing Entities -https://www.acuite.in/view-rating-criteria-59.htm
- Financial Ratios And Adjustments -https://www.acuite.in/view-rating-criteria-53.htm
- Consolidation Of Companies - https://www.acuite.in/view-rating-criteria-60.htm

Note on complexity levels of the rated instrument
https://www.acuite.in/view-rating-criteria-55.htm

Rating History (Upto last three years)

Date	Name of Instrument / Facilities	Term	Amount (Rs. Cr.)	Ratings/Outlook
05-Mar-2019	Cash Credit	Long Term	7.00*	ACUITE A-/Stable (Reaffirmed)
	Buyers Credit	Short Term	2.00	ACUITE A2+ (Withdrawn)
	Letter of Credit	Short Term	2.00	ACUITE A2+ (Reaffirmed)
	Bank guarantee	Short Term	4.00	ACUITE A2+ (Reaffirmed)
	Letter of Credit	Short Term	9.90**	ACUITE A2+ (Reaffirmed)
	Proposed Short Term Loan	Short Term	2.10	ACUITE A2+ (Reaffirmed)
29-Oct-2018	Cash Credit	Long Term	7.00	ACUITE A-/Stable (Reaffirmed)
	Proposed Short Term Loan	Short Term	2.00	ACUITE A2+ (Reaffirmed)
	Bank guarantee	Short Term	4.00	ACUITE A2+ (Reaffirmed)
	Bank guarantee	Short Term	8.00	ACUITE A2+ (Reaffirmed)
	Buyers Credit	Short Term	2.00	ACUITE A2+ (Reaffirmed)
	Letter of Credit	Short Term	2.00	ACUITE A2+ (Reaffirmed)
16-Aug-2017	Cash Credit	Long Term	7.00	ACUITE A-/Stable (Reaffirmed)
	Proposed Short Term Loan	Short Term	2.00	ACUITE A2+ (Reaffirmed)
	Bank guarantee	Short Term	4.00	ACUITE A2+ (Reaffirmed)
	Bank guarantee	Short Term	8.00	ACUITE A2+ (Reaffirmed)
	Buyers Credit	Short Term	2.00	ACUITE A2+ (Reaffirmed)
	Letter of Credit	Short Term	2.00	ACUITE A2+ (Reaffirmed)

*Includes sub limit of (FCNR B) Loan to the extent of Rs.5.00 crore, FBP/UFBP/FCBP/FCBD to the extent of Rs.1.00 crore, Bill Purchase/Bills discounted to the extent of Rs.0.50 crore, Drawing against un-cleared effect (DAUE) to the extent of Rs.0.50 crore
**Includes sub limit of LC (Sight) amounting to Rs.9.90 crore, Bank Guarantee (Financial/ Performance) amounting to Rs.9.90 crore and over draft facility amounting to Rs.7.00 crore.

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Cash Credit	Not Applicable	Not Applicable	Not Applicable	7.00*	ACUITE A-/Negative (Reaffirmed and Outlook Revised)
Overdraft	Not Applicable	Not Applicable	Not Applicable	2.00 **	ACUITE A-/Negative (Reaffirmed and Outlook Revised)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	10.00 ^ (Enhanced from Rs.9.90 crore)	ACUITE A2+ (Reaffirmed)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	2.00	ACUITE A2+ (Reaffirmed)
Bank guarantee	Not Applicable	Not Applicable	Not Applicable	4.00	ACUITE A2+ (Reaffirmed)

*Includes sub limit of FCNR upto Rs. 5.00 crore, FBP/UFBP/FCBP/FCBD up to Rs. 1.00 crore, Bill Purchase/Bills discounted Rs. 0.50 crore, Drawing against un-cleared effect (DAUE) up to Rs. 0.50 crore
**Includes sub limit of bank guarantee up to Rs. 3.00 crore
^Includes sub limit is LC - sight up to Rs. 9.90 crore, Bank Guarantee up to Rs. 9.90 crore and over draft up to Rs. 7.00 crore

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About Acuité Ratings & Research:
Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.