

October 11, 2019

Sudha Somany Ceramics Pvt. Ltd.: Ratings placed on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based TL	78.50	78.50	[ICRA]BBB&; placed on watch with developing implications
Long Term - Fund Based/ CC	13.00	13.00	[ICRA]BBB&; placed on watch with developing implications
Long Term / Short Term - Non Fund Based	5.00	5.00	[ICRA]BBB&/[ICRA]A3+&; placed on watch with developing implications
Total	96.50	96.50	

*Instrument details are provided in Annexure-1

Rationale

ICRA has placed its [ICRA]BBB/[ICRA]A3+ ratings on the long-term/short-term bank facilities of Sudha Somany Ceramics Pvt. Ltd. (SSCPL) on 'Rating watch with developing implication' owing to rating action on Somany Ceramics Ltd's (SCL; rated [ICRA]A1+& placed under watch with developing implications). SCL's rating action follows recent incident of default in payment by a stockbroker¹ and higher inter-corporate deposits (ICDs) to unrelated entities by SCL that raises concerns on the investment policies adopted by the management, given the uncertainty on the credit quality of these exposures.

The ratings continue to factor in the operational and financial support of SSCPL from SCL, leveraging on the latter's strong brand, established market position, vast distribution network and a strong financial profile. The rating favourably factors in the assured offtake of glazed vitrified tiles by SCL along with the favourable location of its manufacturing unit in Andhra Pradesh, in proximity end-consumer markets and raw materials sources, leading to savings in freight costs.

The assigned rating is, however, constrained by the company's limited operational track record with the plant achieving commercial operations (COD) on March 27, 2019 and its moderate scale of operation with an annual capacity of 3.5 million square per metre (MSM). Further, SSCPL's profit margins are vulnerable to fluctuation in raw materials and fuel prices amid an intensely competitive ceramic tile industry. The cyclical nature of the real-estate industry, which is the key end consumer for tiles, is another concern. ICRA also notes that SCL is the sole client of SSCPL and so the company is dependent on the former for revenue growth and remains exposed to any policy changes by SCL in terms of offtake and pricing.

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.

Key rating drivers and their description

Credit strengths

Operational and financial support from SCL- SSCPL is a subsidiary of SCL, with the latter holding a 60% stake in SSCPL while the remaining 40% is held by Sudha Agro Oil and Chemical Industries Limited (SAOCIL), which is into solvent extraction (rice bran and de-oiled bran). The operational and financial support from SCL will help SSCPL in leveraging the former's strong brand presence, established market position and a vast distribution network.

Limited offtake risk- SSCPL had set up a glazed vitrified tile manufacturing facility in Andhra Pradesh with an installed capacity of 3.5 MSM per annum. SSCPL's entire production will be sold to SCL, limiting the offtake risk and enabling savings in terms of the marketing and distribution overheads for SCL. Further, the tiles manufacturing unit is located in Andhra Pradesh, in proximity to raw materials and fuel sources, which is expected to result in saving in freight costs.

Credit challenges

Limited operational track record of the plant- The plant has a limited operational track record as it achieved COD on March 27, 2019. In 5M FY2020, the company has achieved a turnover of Rs. 21.39 crore. A successful ramp-up of the manufacturing unit, leading to achieving the expected scale of operations and profitability, would be a key rating factor.

Profitability to remain susceptible to fluctuation in raw materials and fuel prices- Raw materials and fuel are the two major cost components in tiles production, which determine the cost competitiveness of operations. SSCPL has limited control over the prices of key inputs such as natural gas and other raw materials, exposing its profitability to raw materials and fuel price fluctuations. Though there are provisions to pass on the changes in raw materials prices to its customer, SCL, however, delays in passing on the same, can impact its margins.

Intense competition in the industry- The domestic ceramic tile industry faces intense competition due to the presence of many organised as well as unorganised players. The cyclical nature of the real-estate industry, which is the key end consumer, adds to the challenge of maintaining growth in revenue and operating margins.

Liquidity position: Stretched

SSCPL's liquidity position is stretched as reflected by high average utilisation of working capital limits between April 2019 and August 2019 owing to high inventory levels. The liquidity position is expected to improve in the near term with enhancement in working capital limits. ICRA also expects SSCPL to benefit from the financial support by the promoters, if required.

Rating sensitivities

Positive triggers – ICRA may upgrade SSCPL's rating if the company is able to ramp up its operations profitably and maintain a debt service coverage ratio (DSCR) of more than 1.4 times on a sustained basis.

Negative triggers – Negative pressure on the company's ratings could arise if the company's revenue/profitability is lower than expected or downgrade in SCL's rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	ICRA expects SSCPL to benefit from the financial support extended by the promoters, SCL and SAOCIL, if required.
Consolidation/Standalone	The rating is based on the standalone financial statements of the company.

About the company

SSCPL, incorporated in 2016, is based out of Chittoor district, Andhra Pradesh. It manufactures glazed vitrified tiles with a capacity of 3.5 MSM per annum. The plant achieved COD on March 27, 2019. The company is promoted by Somany Ceramics Limited, which holds a 60% stake in SSCPL, while the remaining 40% stake is held by Sudha Agro Oil and Chemical Industries Limited.

Key financial indicators

	FY2018	FY2019
Operating Income (Rs. crore)	NA	0.3
PAT (Rs. crore)	-0.07	1.0
OPBDIT/OI (%)	NA	-602.6%
RoCE (%)	NA	-3.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.32	5.9
Total Debt/OPBDIT (times)	NA	-56.0
Interest Coverage (times)	NA	-12.9
DSCR	NA	-8.6

Status of non-cooperation with previous CRA:

Not applicable.

Any other information: None

Rating history for past three years

FY2020						Chronology of Rating History for the Past 3 Years		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
1	Term loan	Long Term	58.50	55.14	[ICRA]BBB&	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
2	Term loan 2	Long Term	10.00	10.00	[ICRA]BBB&	[ICRA]BBB (Stable)	-	-
3	Term loan 3	Long Term	10.00	10.00	[ICRA]BBB&	[ICRA]BBB (Stable)	-	-
4	Cash Credit	Long Term	13.00	-	[ICRA]BBB&	[ICRA]BBB (Stable)	-	-
5	Bank Guarantee	Long Term / Short Term	5.00	-	[ICRA]BBB&/[ICRA]A3+&	[ICRA]BBB (Stable)/[ICRA]A3+	-	-

Amount in Rs. Crore; &- under watch with developing implications

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 [click here](#)

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	Term Loan 1	Nov-2017	NA	March 2027	58.50	[ICRA]BBB&
NA	Term Loan 2	Dec 2018	NA	March 2027	10.00	[ICRA]BBB&
NA	Term Loan 3	Dec 2018	NA	September 2021	10.00	[ICRA]BBB&
NA	Cash Credit	-	-	-	13.00	[ICRA]BBB&
NA	Bank Guarantee	-	-	-	5.00	[ICRA]BBB & / [ICRA]A3+&

Source: SSCPL; &- under watch with developing implications

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

Analyst Contacts

K. Ravichandran

+91 44 45964301
ravichandran@icraindia.com

R Srinivasan

+91 44 45964315
r.srinivasan@icraindia.com

Vinay Kumar G

+91 40 4067 6533
vinay.g@icraindia.com

Sankalpa Mohapatra

+91 40 4067 6525
sankalpa.mohapatra@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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