India Ratings Upgrades HeidelbergCement India to 'IND AA+'; Outlook Stable

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By Nitin Bansal

India Ratings and Research (Ind-Ra) has upgraded HeidelbergCement India Limited's (HCIL) Long-Term Issuer Rating to 'IND AA+' from 'IND AA'. The Outlook is Stable. The instrument-wise rating action is as follows.

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bonds	December 2013	10.4%	December 2021	INR3,700	IND AA+/Stable	Upgraded

KEY RATING DRIVERS

Strong Legal Linkages with Parent: The upgrade reflects an upgrade in the ratings of HCIL's ultimate parent HeidelbergCement AG (HCAG, Fitch Ratings Ltd: Issuer Default Rating: 'BBB-'/Stable). HCIL continues to have strong legal, strategic and operational linkages with HCAG, as assessed under the 'Parent and Subsidiary Rating Linkage' criteria. The legal linkages are driven by cross default provisions in HCAG's capital market debt and the group strategy of generally following a group-wide common treasury policy, which is expected to continue in future. The group supports operating companies by providing intercorporate deposits/external commercial borrowings (ECBs), the cost of which is lower than that of raising funds on own by operating companies. As part of this policy, HCIL benefits by way of USD35 million and INR1.5 billion ECBs infused by the parent, along with an INR3.7 billion long-term unsecured bonds (subscribed by the parent) as of December 2016. As of FY16, 97% of the long-term debt (INR 9,842 million) of the company was raised from the parent. As of December 2016, HCIL's standalone capacity was 5.4 million tonnes (mt), equivalent to about 3% of the global cement capacity of HCAG.

Operational linkages are supported, as the parent and the subsidiary operate in the same line of business. Moreover, HCAG is focused on the expansion of its cement business in emerging markets. HCIL has been able to improve its operational performance, as it receives technical support from HeidelbergCement Technology Center. HCIL pays INR170 million in royalty to HCAG for the technical support. HCIL's board of directors has a strong representation from HCAG.

Improvement in EBITDA/t: HCIL's EBITDA/t declined to INR535/t in FY16 (FY15: INR609/t) owing to a fall in realisation (due to soft demand) and an increase costs (due to district mineral fund provision). However, EBITDA/t increased to INR665/t in 9MFY17 from INR496/t in 9MFY16, driven by improved realisations. Moreover, the commissioning of a waste heat recovery unit led to reduced dependence on grid power, thereby supporting power cost savings. There was a temporary blip in volume and profitability due to demonetisation in 3QFY17. Ind-Ra expects EBITDA/t to remain in the range of INR600/t-650/t in FY17.

Standalone Credit Profile to Improve from FY17: HCIL's credit profile remained flat in FY16 in line with Ind-Ra expectations. In FY16, net adjusted leverage was 4.4x (FY15: 4.47x (adjusted for 12 months)). However, EBITDA significantly improved to INR2,170 million in 9MFY17 (9MFY16: INR1,653 million). With large repayments in FY17, Ind-Ra expects net adjusted leverage to reach 3.2x-3.5x. There is a possibility of a gradual improvement in net adjusted leverage on account of debt repayments scheduled over FY17-FY20.

Volume to Grow Gradually: HCIL's volume grew 3.9% yoy to 4.4mt in FY16. However, volume declined about 2.1% yoy to 3.26mt in 9MFY17. The decline was due to heavy rains and demonetisation. Capacity utilisation was 81% in 9MFY17 (FY16: 82%; FY15: 79%). Ind-Ra expects cement demand to gradually grow on account of the government's continued focus on infrastructure. Given limited capacity addition coming up in central India over the next two years, Ind-Ra expects a gradual improvement in capacity utilisation of HCIL. However, there remains a risk of a decline in capacity utilisation owing to oversupply in the region in the event of increased capacity utilisation of plants acquired by Ultratech Cement Limited ('IND AAA'/Stable) from Jaiprakash Associates Limited. Ultratech Cement and HCIL have common markets in Uttar Pradesh (UP) and Madhya Pradesh.

Liquidity Pressure: HCIL, which repaid a USD30 million debt during 9MFY17, has to repay USD15 million and USD20 million in debt in 4QFY17 and FY18, respectively. Ind-Ra expects a substantial improvement in cash flow generation in FY17 on account of an improved operating performance. Given HCIL has a large repayment due in 4QFY17, Ind-Ra expects HCIL to draw down fund-based limits or receive an interest free loan from the UP government.

In FY16, HCIL received an interest free loan of INR336 million for the expansion of its Jhansi plant from The Pradeshiya Industrial and Investment Corporation of U.P. Ltd. as per the Industrial Investment Promotion Scheme-2012, Uttar Pradesh. Under this scheme, HCIL is entitled to receive an interest free loan equivalent to value added tax and central sales tax paid from the incremental capacity to the UP government or 10% of the annual turnover from the incremental capacity in UP, whichever is lower, for 10 years. Ind-Ra draws comfort from HCIL's linkages with HCAG, available cash (1HFY17: INR202 million) and access to a bank funding of INR2.6 billion fund-based limits (fully interchangeable with non-fund based limits).

Completion of Italcementi Acquisition by HCAG: In October 2016, HCAG completed the acquisition of Italcementi S.p.A, a leading global cement company. The combined entity is the second-largest cement producer globally, with presence in over 60 countries. In India, Italcementi has presence through its wholly owned subsidiary, Zuari Cement Limited (ZCL; 'IND AA'/Stable), increasing HCAG's presence in the country. ZCL has presence in southern India, with a capacity of 7.1mt. ZCL is strategically important to HCAG in India, as it has enabled the group to double its cement capacity. ZCL caters to southern India. Meanwhile, HCIL derives close to 95% of its revenue from Madhya Pradesh and UP.

RATING SENSITIVITIES

Positive: An improvement in the linkages between HCAG and HCIL will lead to a positive rating action.

Negative: Future developments that could, individually and collectively, lead to a negative rating action are:
- a rating downgrade of HCAG; and
- a deterioration in the linkages between HCAG and HCIL, including sustained underperformance of the Indian business.

COMPANY PROFILE

HCIL has three manufacturing facilities across central India (Madhya Pradesh and UP: 4.8mt) and southern India (Karnataka: 0.6mt).

In FY16, HCIL's revenue was INR16.5 billion (FY15: INR20.4 billion (15 months)), EBITDA was INR2,377 million (INR3,222 million) and profit after tax was INR386 million (INR595 million). In 9MFY17, HCIL's revenue was INR12.7 billion, EBITDA was INR2,169 million and profit after tax was INR392 million. At FYE16, HCIL had an outstanding debt of INR9,459 million (net of derivative asset of INR1,083 million).

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Outstanding Limits (million)	Rating/Outlook	1 March 2016	23 January 2015	28 November 2013
Issuer rating	Long-term	-	IND AA+/Stable	IND AA/Stable	IND AA-/Stable	IND AA-/Stable
Bonds	Long-term	INR3,700	IND AA+/Stable	IND AA/Stable	IND AA-	IND AA-

COMPLEXITY LEVEL OF INSTRUMENTS

Bonds are instruments are instruments with low complexity levels, where the relationship between inherent risk factors and intrinsic return characteristics is straightforward.

For more information, visit https://www.indiaratings.co.in/complexity-indicators.

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Applicable Criteria

Corporate Rating Methodology

Analyst Names

Primary Analyst
Nitin Bansal

Analyst
India Ratings & Research A Fitch Group Company 601, Prakashdeep Building 7, Tolstoy Marg
New Delhi 110001 India
+91 11 43567230

Secondary Analyst
Vivek Jain

Associate Director
+91 11 43567249

Committee Chairperson
Salil Garg

Director
+91 1143567244

Media Relation
Mihir Mukherjee

Manager Corporate Communications and Investor Relations
+91 22 40356121