January 29, 2021

Suraj Industries: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash credit	30.00	30.00	[ICRA]BBB+(Stable); reaffirmed
Term loans	33.00	17.75	[ICRA]BBB+(Stable); reaffirmed
Bank Guarantee	2.00	2.00	[ICRA]A2+; reaffirmed
Unallocated limits	-	15.25	[ICRA]BBB+(Stable); reaffirmed
Total	**65.00**	**65.00**	

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the rating, ICRA has taken a consolidated view of the SRV Group of entities, namely Suraj Industries (SI), SRV Synthetics (SRVS) and SRV Polytex Private Limited (SRVPPL), given their strong operational and financial linkages, presence in the same business sector as well as common management control.

The rating reaffirmation continues to factor in the extensive experience of the SRV Group's promoters in the textile industry as well as its established and geographically diversified customer base. The rating continues to derive comfort from the Group's presence in high value-added yarn, coupled with forward integration into fabric knitting and accompanying fiscal benefits under the Technology Upgradation Fund Scheme (TUFS) which aid in margin expansion. Further, despite the debt-funded capex, the Group's capital structure and coverage indicators continue to remain comfortable given its relatively strong net worth base and adequate cash accruals in the business.

The rating, however, remains constrained by the vulnerability of SRV Group's operating income (OI) to cyclicality inherent in the textile industry, which has resulted in a muted revenue growth in FY2020 and the expected pressure on the Group's revenues and profitability in the current fiscal on account of the Covid-19 induced disruption in the business. Further, relatively high capex requirement in the business has resulted in moderate return indicators. The rating also remains constrained by the limited bargaining power of the Group and the resultant susceptibility of its profitability to volatility in raw material costs, primarily partially oriented yarn (POY), which is a crude oil derivative. Further, the rating continues to note the Group's presence in a highly fragmented textile industry along with intense competition from well-established domestic players. The rating also continues to remain constrained by the risks associated with the partnership constitution of two of the entities in the SRV Group. This includes risks such as capital withdrawals and dissolution due to insolvency/retirement/death of partners.

The Stable outlook reflects ICRA's opinion that the Group will continue to benefit from the extensive experience of its partners in the textile industry, and from the Group's increasing focus on higher value textile products supported by its regular capex, which will render support to its scale of operation and margin expansion in the medium to long-term.

Key rating drivers and their description

Credit strengths

Extensive industry experience of key promoters in the textile industry – With extensive knowledge and experience in the textile industry, the key promoters, Mr. Rajendra Shah and Mr. Sudhir Shah along with the second generation of the family, have established SRV Group's significance in the textile market. Over the years, the Group has undertaken technological upgradation in its manufacturing facility to comply with the latest consumer requirements that enhance credibility.

Well established distribution network coupled with geographically diversified and established client base – SRV Group manufactures yarn, which is sold through more than 200 agents. Initially, the distribution was limited to the Maharashtra region. However, over the last 10 years, the Group has diversified its geographical reach to Bhilwara (Rajasthan) and Surat (Gujarat). In addition, the Group's sales distribution is geographically diversified with exposure to the export markets of Ethiopia, Sri Lanka, Thailand, Bangladesh and a few other African markets through SRVS. However, exports remained low in the range of ~5% of the total sales over the last three years.

Presence in high value yarn along with forward integration into fabric knitting; accompanying fiscal benefits in the form of TUFS aid in margin expansion – Over the years, the Group has increased its focus towards manufacturing high value-add yarn, which accounts for most of its total yarn production and has been witnessing healthy offtake from denim and other apparel manufacturers. In addition, the Group has forward integrated its operations by manufacturing greige knitted fabric, which is primarily used in the hosiery industry. It has begun captive consumption of this yarn, which has resulted in a growth of 7.2% in FY2020 from 5.7% in operating profitability in FY2019. Further, the Group is also entitled to fiscal benefits in the form of tax incentives and capital subsidy benefits like TUFS, which enables it to maintain its profitability margins.

Comfortable capital structure and satisfactory debt metrics – Despite the debt-funded capex, the capital structure of the Group continued to remain comfortable with a gearing level of 0.4 time as on March 31, 2020, which improved from 0.5 time as on March 31, 2019. The improvement in capital structure in FY2020 was mainly on account of improvement in operating profitability and cash flow, which resulted in low utilisation of the working capital limits. Aided by declining debt levels as well as improvement in profitability, the coverage indicators as reflected by OPBDITA/Interest improved to 5.6 times and Total debt/OPBDITA to 1.7 times in FY2020 from 4.3 times and 2.4 times, respectively, in FY2019.

Credit challenges

Pressure on revenue and profitability in current fiscal from pandemic induced disruption in business environment, along with discretionary consumer spending and recalibrated lifestyles – SRV Group's sales, profitability and cash accruals, like any other textile player, are closely linked to macro-economic conditions, consumer confidence and spending patterns, particularly considering the discretionary nature of its products. In addition, with the expected adverse impact of the Covid-19 pandemic on the textile industry, ICRA expects its operating performance to remain under pressure in FY2021. The same is largely because of the prevalent weak demand conditions and potential change in consumer behaviour towards visiting public places. Consequently, the Group's revenues have halved at Rs. 143 crore in 8M FY2021, against Rs. 289 crore during 8M FY2020, which is likely to impact its profitability to some extent given the lower absorption of fixed costs.

Susceptibility of operating revenues and profitability to cyclicality inherent in the textile industry; profitability margins vulnerable to volatility in raw material costs – Despite the sizable capex, SRV Group's operating income continue to grow at a muted pace to Rs. 407 crore in FY2020 from Rs. 387 crore in FY2019. Nevertheless, given the economies of scale arising from the increase in the knitting capacity coupled with captive consumption of raw material requirement of the fabric division, the profitability levels of the Group remained protected, and even improved due to increased product offtake of the relatively more profitable spandex yarn and the newly commissioned fabric division. On a consolidated basis, the Group reported an improvement in the operating margin, which stood at 7.2% in FY2020 from 5.7% in FY2019. The prices of the key raw material, POY (manufactured using PET chips), being a crude oil derivative, witnessed sharp fluctuations over the last three years. Although the Group benefits from bulk purchase of raw materials, its profitability remains exposed to adverse fluctuations in the prices of these key raw materials and its ability to pass on the same to its customers.

Risks associated with partnership firms – Due to its partnership constitution, the entity is exposed to the risk of capital withdrawals, dissolution due to insolvency/ death/ retirement of partners.

Intense competition from other established players in the industry – Despite the established position of the SRV Group in the domestic market, it faces strong competition from other established players in the domestic and international markets. This limits its ability to pass on any increase in input costs to its customers, thereby exposing its profitability to fluctuation in raw-material prices.

Liquidity position: Adequate

SRV Group's liquidity remains Adequate, with no major capex plans in the pipeline and limited debt repayment obligations. The Group's adequate liquidity position is corroborated by its cash and liquid investments and undrawn working capital facilities, aggregating to approximately Rs. 40 crore as of December 31, 2020. The Group has also prepaid its term loans to a certain extent due to availability of surplus funds. Despite the expected pressure on revenues and profitability in the currency year, due to the Covid-19 pandemic, the liquidity would be sufficient for covering the repayment liabilities and fixed cost over the near-term.

Rating sensitivities

Positive factors – ICRA could upgrade SRV Group's rating if it demonstrates a notable improvement in the operating income and profitability translating into an overall improvement in the return on capital employed.

Negative factors – Negative pressure on rating could trigger in case of higher than anticipated decline in scale of operations, which significantly impacts the profitability. Specific metrics include interest coverage below 3.3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry–Spinning Rating Methodology for Entities in the Indian Textiles Industry –Fabric Making
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of the various group entities (as mentioned in Annexure-2) given the close business, financial and managerial linkages among them.

About the company

Established in 2004, Suraj Industries is engaged in manufacturing texturised yarn and high value-added yarn in deniers ranging between 80 and 600, where the denier mix is determined by the profitability available for the respective deniers. The firm has diversified its operations by way of forward integration into manufacturing greige knitted fabric from FY2019. Its manufacturing facility is located at Silvassa in the Union Territory of Dadra and Nagar Haveli.

About the Group

The SRV Group includes three entities, namely Suraj Industries, SRV Synthetics and SRV Polytex Private Limited[1]. While SRVPPL is just an investment arm, SRVS and SI are engaged in the business of manufacturing greige knitted fabric and high value-added yarn in deniers ranging between 80 and 600.

In FY2020, the Group reported a profit after tax (PAT) of Rs. 12.9 crore on an OI of Rs. 407.4 crore, over a net PAT of Rs. 3.7 crore on an OI of Rs. 382.8 crore in the previous year.

[1] *The rating of SRV Polytex Private Limited was withdrawn in March 2013 with the bank facilities being repaid by the entity.*

Key financial indicators (audited)

SRV Group Consolidated	FY2018	FY2019	FY2020*
Operating Income (Rs. crore)	386.9	382.8	407.4
PAT (Rs. crore)	8.2	3.7	12.9
OPBDIT/OI (%)	4.8%	5.7%	7.2%
RoCE (%)	13.7%	8.6%	12.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.6	0.4
Total Debt/OPBDIT (times)	2.9	2.4	1.7
Interest Coverage (times)	3.8	4.3	5.6
DSCR (times)	3.6	2.9	2.4

**Unaudited*

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

<table>
<tr><th rowspan="3"></th><th rowspan="3">Instrument</th><th colspan="4">Current Rating (FY2021)</th><th colspan="3">Chronology of Rating History</th></tr>
<tr><th rowspan="2">Type</th><th rowspan="2">Amount Rated (Rs. crore)</th><th rowspan="2">Amount Outstanding as of Feb 29, 2020 (Rs. crore)</th><th>Date & Rating in</th><th>Date & Rating in FY2020</th><th>Date & Rating in FY2019</th><th>Date & Rating in FY2018</th></tr>
<tr><th>Jan 29, 2020</th><th>Oct 04, 2019,</th><th>Jul 12, 2018</th><th>Apr 10, 2017</th></tr>
<tr><td>1</td><td>Cash credit</td><td>Long-term</td><td>30.00</td><td></td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td></tr>
<tr><td>2</td><td>Term loan</td><td>Long-term</td><td>17.75</td><td>17.75</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td></tr>
<tr><td>3</td><td>Bank Guarantee</td><td>Short-term</td><td>2.00</td><td></td><td>[ICRA]A2+</td><td>[ICRA]A2+</td><td>[ICRA]A2+</td><td>[ICRA]A2+</td></tr>
<tr><td>4</td><td>Unallocated limits</td><td>Long-term</td><td>15.25</td><td></td><td>[ICRA]BBB+ (Stable)</td><td></td><td></td><td></td></tr>
</table>

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	Cash credit				30.00	[ICRA]BBB+(Stable)
NA	Term loans	FY2018	NA	FY2027	17.75	[ICRA]BBB+(Stable)
NA	Bank Guarantee				2.00	[ICRA]A2+
NA	Unallocated limits				15.25	[ICRA]BBB+(Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
SRV Synthetics	-	Full Consolidation
SRV Polytex Private Limited	-	Full Consolidation

Note: *ICRA has taken a consolidated view of the Group entities while assigning the ratings.*

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About ICRA Limited:

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