October 31, 2022

Sri Dhanalakshmi Cotton & Rice Mills Pvt. Ltd.: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based/ CC	53.50	53.50	[ICRA]A (Stable); reaffirmed
Short-term – Fund-based	15.00	15.00	[ICRA]A1; reaffirmed
Short-term – Non-fund Based	8.00	8.00	[ICRA]A1; reaffirmed
Long-term – Unallocated	45.34	45.34	[ICRA]A (Stable); reaffirmed
Total	**121.84**	**121.84**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings favourably factor in the extensive experience of the company in the cotton industry. Besides, operational efficiency arises from the vertically integrated nature of Sri Dhanalakshmi Cotton & Rice Mills Pvt. Ltd.'s (SDC) operations, with its presence in spinning, weaving, and oil extraction and refining, along with captive hydel power and wind generation. SDC has an established market presence in the cotton seed oil industry and is one of the largest cotton seed oil extractors in India. The company's revenue grew by 9% in FY2022 owing to increased realisations across segments and higher revenue contribution from the spinning and textile division. However, in H1 FY2023, revenues declined by 33% (annualised) as production was impacted by limited availability of cotton and as the company chose to curtail production and limit its losses amid high cotton seed and cotton lint prices. While fresh cotton arrivals from the kharif crop are expected to improve raw material availability and support revenues in H2 FY2023, ICRA estimates the company's revenues to decline by 20-30% in FY2023. SDC recorded marginal operating loss in H1 FY2023 owing to high raw material costs; however, profitability is expected to improve in H2 FY2023. Nevertheless, despite low earnings expected for FY2023, the company's capital structure is likely to remain comfortable with low debt levels, while debt coverage metrics are expected to remain healthy. ICRA also notes the locational advantage of SDC's plant in Guntur district of Andhra Pradesh, a prominent cotton growing belt, resulting in easy access to raw materials.

The ratings, however, remain constrained by the susceptibility of the company's revenues and margins to the availability and prices of cotton, which is an agro commodity. The company operates in a highly fragmented industry with commoditised nature of products restricting pricing flexibility and bargaining power to an extent. Besides, there is high customer concentration risk in the fabric division as the top five customers accounted for over 80-85% of the division's sales during the last three years.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that SDC will continue to benefit from its established presence in the cotton industry and its vertically integrated operations. ICRA also believes that the company will maintain a healthy financial profile and strong liquidity position, despite the expected moderation in its revenues and margins in FY2023.

Key rating drivers and their description

Credit strengths

Extensive experience in cotton industry and location of plant in cotton growing region – The company has an established presence in the textiles and cotton seed oil industries. It is one of the largest cotton seed oil extractors in India with a 600-MTPD seed processing capacity, 280-MTPD solvent extraction capacity and 50-MTPD refining capacity. Moreover, SDC enjoys established relationships with its suppliers and customers, resulting in repeat orders. SDC's spinning division (cotton yarn) has an installed capacity of 76,608 spindles; its fabric division has 120 looms; the hydel power division has a 6.2-MW power generation capacity, and its windmill a capacity of 15.3 MW. It also enjoys location-specific advantages, as its plant is located near the major cotton growing belt of Guntur, Andhra Pradesh, resulting in easy access to raw materials.

Integrated nature of operations – The company's revenue profile is diversified with vertically-integrated operations comprising spinning, weaving, oil extraction and refining, along with captive hydel power and wind energy generation, resulting in operational efficiency. Further, ~35% of the yarn requirement of its fabric division was met through in-house production, while ~60% of its total power requirement was met through captive power generation in FY2022.

Healthy capital structure and coverage indicators – The company's capital structure remained healthy with no repayment of term loans, including lower working capital borrowings and no major debt-funded capex. Coupled with improved net worth owing higher accretion to reserves, this led the gearing to be in line with FY2022 levels at 0.0 times as on September 30, 2022. Further, the coverage indicators are likely to remain comfortable despite decrease in operating margins to 3–5% in FY2023 because of low revenues and operating losses in H1 FY2023 owing to high raw material costs. Going forward, the overall financial profile will remain comfortable in the absence of any major debt-funded capex and limited external borrowing.

Credit challenges

Susceptibility of profitability to volatile cotton prices and captive power generation capacity – Raw material costs are the company's major costs, accounting for close to 75% of its revenues over the past four years. Like other entities in the cotton industry, SDC stocks cotton during the harvest season to meet a significant portion of its off-season requirements. This stocking exposes the company to fluctuations in cotton and yarn prices during the non-harvest period, as the procurement cost is fixed, while the realisation fluctuates with cotton prices, which are driven by domestic and global factors. Firm cotton prices and pressure on realisations had constrained its contribution levels in the past. Nevertheless, the energy generated through SDC's captive power plant at a cheap rate positively impacts the cost structure.

Exposed to regulatory and agroclimatic risks – The company's revenues and margins are exposed to agroclimatic risks as availability and pricing of cotton are seasonal, with the cotton season typically running from mid-September to March. SDC is also exposed to regulatory risks with respect to the minimum support price (MSP) for raw cotton, which is decided by the Government every year.

High customer concentration risk in weaving division – The customer concentration risk is high in the fabric division with the top five customers accounting for 85-90% of the division's sales during the past three years ending FY2022.

Commoditised nature of products and fragmented industry structure restrict pricing power and profitability – The spinning and knitting industries are highly fragmented with a significant share of the market occupied by unorganised players. While SDC manufactures a wide variety of products encompassing yarns with varying levels of value addition and knitted fabrics, its product portfolio continues to be concentrated towards medium-count yarns and fabrics. As a result, it enjoys limited pricing power, which is likely to keep its profitability under check.

Liquidity position: Strong

The liquidity position is strong with unutilised working capital limits of ~Rs. 40.0–50.0 crore and free cash and bank balances of Rs. 106.4 crore as on September 30, 2022. The inventory holding would increase, going forward, as the company stocks up during the cotton harvest; however, despite expected increase in inventory holding, the company is expected to have healthy free cash balances and buffer in working capital limits. Moreover, the company does not have any major capex plans in the near to medium term and neither any term loan debt repayment obligations.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company shows significant sustained growth in revenues, operating profitability and accruals while maintaining a strong liquidity position.

Negative factors – Negative pressure on SDC's rating could arise in the absence of material recovery in its earnings, or if its receivables increase, or if inventory holding impacts its liquidity position. Any major debt-funded capex adversely impacting the liquidity profile and debt-protection metrics could also exert pressure on the ratings. Specific credit metric that could lead to a rating downgrade include Total Debt/OPBDITA higher than 2.0 times on sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Edible Oil (Solvent Extraction) Industry Rating Methodology for Indian Textiles Industry– Spinning Rating Methodology for Indian Textiles Industry – Fabric
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the company's standalone financial profile.

About the company

SDC, located in Guntur, Andhra Pradesh, was set up in 1977. It is managed by Mr. N. Raghava Rao, Mr. P. Raghava Reddy, Mr. P.V. Narayana, Mr. S. Hanumantha Rao and Mr. M. Lingaiah. The company, a closely held business, operates across oil extraction, cotton spinning, weaving, hydel power and wind power sectors, all located in Guntur and nearby regions, a major cotton producing belt. It also owns a 9-MW windmill in Tamil Nadu. SDC's spinning division (cotton yarn) has an installed capacity of 76,608 spindles, the cotton seed oil division enjoys 600 MTPD of seed processing capacity, followed by the solvent extraction division (280 MTPD capacity) and the refining division (50 MTPD), while the fabric division has 120 looms, the hydel power division generates 6.2 MW, and the wind mill 15.3 MW of captive energy.

Key financial indicators (audited)

	FY2021	FY2022*	H1 FY2023*
Operating income	503.4	548.9	185.0
PAT	29.7	33.2	(5.4)
OPBDIT/OI	10.8%	10.3%	-0.3%
PAT/OI	5.9%	6.1%	-2.9%
Total outside liabilities/Tangible net worth (times)	0.3	0.2	-
Total debt/OPBDIT (times)	0.3	0.1	-
Interest coverage (times)	26.8	123.2	(18.4)

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Provisional*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Oct 31, 2022	July 26, 2021	April 3, 2020	June 12, 2019
1	**Cash Credit**	Long term	53.50	-	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**
2	**Fund-based**	Short term	15.00	-	**[ICRA]A1**	**[ICRA]A1**	-	-
3	**Non-fund based**	Short term	8.00	-	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A2+**	**[ICRA]A2+**
4	**Unallocated**	Long term	45.34	-	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**
5	**Term loans**	-	-	-	-	-	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Short-term Fund-based	Simple
Short-term Non-fund-based	Very Simple
Unallocated	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Cash Credit**	NA	NA	NA	53.50	[ICRA]A (Stable)
NA	**Working capital demand loan**	NA	NA	NA	10.00	[ICRA]A1
NA	**Short Term Loan**	NA	NA	NA	5.00	[ICRA]A1
NA	**Letter of Credit**	NA	NA	NA	7.30	[ICRA]A1
NA	**Bank Guarantee**	NA	NA	NA	0.50	[ICRA]A1
NA	**CEL**	NA	NA	NA	0.20	[ICRA]A1
NA	**Unallocated**	NA	NA	NA	45.34	[ICRA]A(Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Srikumar K
+91 44 45964318
ksrikumar@icraindia.com

Nithya Debbadi
+91 40 40676515
nithya.debbadi@icraindia.com

Raviteja Etikala
+91 40 40676529
etikala.teja@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

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches