May 31, 2023

Deepak Spinners Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Cash Credit	55.00	60.00	[ICRA]A- (Stable); Reaffirmed
Fund Based – Standby Line of Credit	5.00	5.00	[ICRA]A2+; Reaffirmed
Fund Based – Export Packing Credit (Interchangeable)^	(15.00)	(15.00)	[ICRA]A2+; Reaffirmed
Fund Based – Bill Discounting (Interchangeable)^	(15.00)	(15.00)	[ICRA]A2+; Reaffirmed
Fund Based – Term Loan (Covid loan/CCECL)	2.00	-	-
Fund Based – Term Loan	14.10	8.90	[ICRA]A- (Stable); Reaffirmed
Non-Fund Based – Letter of Credit	2.00	2.00	[ICRA]A2+; Reaffirmed
Non-Fund Based – Capex Letter of Credit	10.00	10.00	[ICRA]A2+; Reaffirmed
Non-Fund Based – Bank Guarantee	3.00	3.00	[ICRA]A- (Stable); Reaffirmed
Non-Fund Based – Credit Exposure Limit	1.00	1.00	[ICRA]A2+; Reaffirmed
Unallocated limit	-	2.20	[ICRA]A- (Stable) / [ICRA]A2+; Reaffirmed
Total	**92.10**	**92.10**	

**Instrument details are provided in Annexure-1; ^Within the overall fund based working capital limit*

Rationale

The ratings reaffirmation continues to consider Deepak Spinners Limited's (DSL) long operational track record of more than three decades in manufacturing of blended synthetic yarns and its established relationship with customers, which lead to repeat orders and mitigate counterparty risks. The ratings also draw comfort from the company's comfortable financial profile, aided by healthy cash accruals, a conservative capital structure, with a steady decline in its debt level since FY2018, and comfortable debt coverage metrics. ICRA also notes DSL's efficient operations, marked by its high capacity utilisation and the company's cost optimisation initiatives, which are likely to support its profitability. The ratings, however, are constrained by a fragmented structure of the spinning industry, leading to competition among many organised and unorganised players, keeping margins under check. DSL's product-market diversity remains moderate, given its presence mainly in the coarse-count yarns segment and a modest share of export sales, notwithstanding higher realisations fetched from exports of relatively value-added products. Besides, the company's profitability and cash flows are likely to remain vulnerable to the cyclicality inherent in the textiles sector and the volatility in crude-oil linked raw material prices and realisations. An uptrend in the crude oil prices led to an improvement in its realisations in FY2022, in turn, leading to an increase in the operating margin to 13.3% in FY2022 vis-à-vis 10.7% in FY2021. DSL's operating margin normalised to around 11% in the last two quarters of FY2023, on the back of softening of realisation, leading to a marginal decline in the full-year operating margin to 12.7% in FY2023. Weakening of demand and moderation in realisations are likely to negatively impact DSL's revenue and profitability in the current fiscal. Nevertheless, the company's profits and cash accruals at an absolute level are likely to remain healthy.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that DSL's credit profile is likely to remain comfortable despite a likely moderation in its performance in the current fiscal. While planned capex of around Rs. 80 crore till FY2025 is unlikely to materially impact the company's liquidity and capital structure, the same is likely to support DSL's cost structure, going forward, by way of higher value addition and efficiency improvement.

Key rating drivers and their description

Credit strengths

Long operational track record in manufacturing of blended synthetic yarns – The company's plant at Baddi, Himachal Pradesh commenced operation in 1986. Subsequently, it had set up another plant at Guna, Madhya Pradesh in 1991 and gradually increased capacities of both the plants. Since the beginning, DSL has been involved in manufacturing of blended synthetic yarns. A long track record of operation and experience of the promoters in the industry mitigate DSL's business risks.

Established relationship with customers – DSL sells its products mainly through dealers and agents. In addition, it directly supplies yarns to a few large players in the apparel/fabric segments. The company's established relationship with its customers fetches repeat orders and mitigates counterparty risks.

Efficient operations reflected by high capacity utilisation; cost optimisation initiatives likely to support profitability – The company's capacity utilisation had historically remained high. The same declined to 82% in FY2021 from 93% in FY2020 due to the pandemic, however, the capacity utilisation improved to 96% in FY2022 and 98% in FY2023. An increase in the captive solar power capacity at the company's plant in Madhya Pradesh is likely to reduce the overall power cost. DSL plans to add more solar power capacity in the coming two years. It is also undertaking capex for efficiency improvement and for increasing value addition by expanding the dyeing capacity. The company is also focusing on controlling cost, manpower rationalisation etc, which are likely to support its profit margins in future.

Financial profile characterised by healthy cash accruals, conservative capital structure and comfortable debt coverage metrics – DSL's net cash accrual remained strong in the range of Rs. 52-55 crore over the last two fiscals. The same is likely to reduce with normalisation of revenues and profitability from an elevated level, which was supported by buoyant demand and realisations after the pandemic. However, the cash accrual is likely to remain healthy, going forward. The company's debt level declined gradually over the last few years with repayment of long-term loans and reduction in working capital borrowings. The gearing declined steadily to 0.2 times as on March 31, 2022 from 1.4 times as on March 31, 2017 and remained low at 0.2 times as on March 31, 2023. DSL's debt coverage metrics improved significantly in FY2022, aided by improved profits and reduction in debt, and remained strong in FY2023, as reflected by an interest coverage of 24.8 times (16.1 times in FY2022), total debt relative to OPBDITA of 0.7 times (0.7 times in FY2022) and net cash accrual relative to total debt of 111% (106% in FY2022). The debt coverage metrics are likely to remain comfortable, going forward, despite a likely moderation in profits.

Credit challenges

Highly fragmented and competitive nature of the industry – The Indian spinning industry is highly fragmented, with the presence of many organised and unorganised players. Competition among the spinners keeps margins under check. Nevertheless, DSL's high capacity utilisation (98% in FY2023) and the presence of captive renewable power sources, which currently meet around 25% of the power requirement of its plant in Madhya Pradesh at a cheap rate, positively impact the cost structure. Besides, the company's operational flexibility to supply customised products to its customers renders competitive advantage to an extent.

Moderate product-market diversity – DSL mainly manufactures coarse-count grey and dyed yarns of 8-30 counts. The product profile is largely commoditised despite the presence of some value-added and usage-specific products ('melange', sewing threads etc). The company fetches better realisations from export of relatively value-added products. However, the contribution of exports to DSL's overall revenue remains low (10% in FY2023).

Exposed to volatility in raw material prices and realisations along with cyclicality inherent in the industry – The company's raw materials mainly comprise staple manmade fibres like polyester, viscose and acrylic fibres, with around 95% share of polyester in the fibre consumption. The raw material prices and realisations remain highly correlated to crude oil prices and exhibit significant volatility, which along with a cyclical demand pattern for synthetic yarns may impact the profitability and cash flows of all the players in the industry, including DSL. The company's performance improved significantly after the pandemic due to a spurt in demand and a sharp rally in realisations, as reflected by healthy revenues and elevated operating margins in FY2022 and in H1 FY2023. However, with a slowdown in demand and moderation in realisations, the company's revenues and profitability started normalising from Q3 FY2023, which is likely to continue in the near term.

Environmental and Social Risks

Environmental considerations: Synthetic materials made from petrochemicals/ crude oil derivatives are not readily biodegradable, resulting in long-term environmental pollution. Besides, environmental risk for spinners arises from the use of electricity to power the manufacturing units and use of water resources for cleaning and for other manufacturing processes like dyeing in relatively integrated facilities. DSL has a dyeing facility in one of its units. It complies with environmental regulations. However, the company would remain exposed to tightening environmental regulations related to breach of waste and pollution norms, which can lead to an increase in the operating costs and new equipment/ capacity installation costs. Availability issues and/or a shift in preference towards more environment-friendly alternatives could result in demand-related concerns for MMF spinners in the long term.

Social considerations: The social risk for spinning companies emanates from high labour involvement despite increasing mechanisation. The sector is exposed to labour-relation risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. Entities in the spinning sector are also exposed to risks of disruptions due to inability to properly manage the human capital in terms of their safety and overall wellbeing.

Liquidity position: Adequate

DSL's liquidity is likely to remain **adequate**. Its cash flow from operations stood at around Rs. 41 crore in FY2023 and is likely to remain healthy, going forward. It has moderate debt repayment obligations of around Rs. 4-6 crore annually till FY2025. The company plans to incur a sizeable capex of around Rs. 80 crore till FY2025. However, the healthy cash flow from operations and sizeable headroom in working capital utilisation, with an undrawn limit of around Rs. 18 crore as of March 2023, are likely to support DSL's liquidity. The company's working capital limit has increased by Rs. 5 crore from April 2023, which will provide an additional liquidity cushion.

Rating sensitivities

Positive factors – ICRA may upgrade DSL's ratings if its revenues and cash accruals improve significantly on a sustained basis. Specific credit metrics that may lead to an upgrade of the ratings include ROCE above 15% on a sustained basis.

Negative factors – Pressure on DSL's ratings may arise if its revenues and profitability deteriorate significantly. A sustained increase in total debt/OPBDITA above 2.3 times may also trigger a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of the rated entity

About the company

Incorporated in 1982 by Mr. Pradip Kumar Daga, Deepak Spinners Limited manufactures blended synthetic spun yarns. The company has two plants at Baddi in Himachal Pradesh and at Guna in Madhya Pradesh with a total spinning capacity of around 37,000 metric tonnes per annum. The Baddi and Guna units have around 38,000 and 53,000 spindles, respectively. Additionally, the Baddi unit has a dye house. The company mainly produces synthetic yarns of 8-30 counts. The Guna plant has captive solar power plants of 4 mega-watt (MW), including 3 MW commissioned in FY2023. It also draws power from a 5-MW solar power plant of its Group company, Deepak Industries Limited (DIL). The company has a 3-MW biomass-based captive power plant at Guna, however, the same has been shut down due to reduced availability of fuel (paddy husk).

Key financial indicators (audited)

DSL (Standalone)	FY2022	FY2023
Operating income	529.3	562.2
PAT	39.3	40.1
OPBDIT/OI	13.3%	12.7%
PAT/OI	7.4%	7.1%
Total outside liabilities/Tangible net worth (times)	0.5	0.5
Total debt/OPBDIT (times)	0.7	0.7
Interest coverage (times)	16.1	24.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					May 31, 2023	-	Feb 15, 2022	-
1	**Fund Based – Cash Credit**	Long term	60.00	-	**[ICRA]A- (Stable)**	-	[ICRA]A- (Stable)	-
2	**Fund Based – Standby Line of Credit**	Short term	5.00	-	**[ICRA]A2+**	-	[ICRA]A2+	-
3	**Fund Based – Export Packing Credit (Interchangeable)***	Short term	(15.00)	-	**[ICRA]A2+**	-	[ICRA]A2+	-
4	**Fund Based – Bill Discounting (Interchangeable)***	Short term	(15.00)	-	**[ICRA]A2+**	-	[ICRA]A2+	-
5	**Fund Based – Term Loan (Covid loan/CCECL)**	Long term	-	-	-		[ICRA]A- (Stable)	-
6	**Fund Based – Term Loan**	Long term	8.90	8.86	**[ICRA]A- (Stable)**	-	[ICRA]A- (Stable)	-

7	**Non-Fund Based – Letter of Credit**	Short term	2.00	-	**[ICRA]A2+**	-	[ICRA]A2+	-
8	**Non-Fund Based – Capex Letter of Credit**	Short term	10.00	-	**[ICRA]A2+**	-	[ICRA]A2+	-
9	**Non-Fund Based – Bank Guarantee**	Long term	3.00	-	**[ICRA]A- (Stable)**	-	[ICRA]A- (Stable)	-
10	**Non-Fund Based – Credit Exposure Limit**	Short term	1.00	-	**[ICRA]A2+**	-	[ICRA]A2+	-
11	**Unallocated limit**	Long/ Short term	2.20		**[ICRA]A- (Stable) / [ICRA]A2+**	-	-	-

**Within the overall fund based working capital limit*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term – Fund Based (Cash Credit)	Simple
Short term – Fund Based (Standby Line of Credit)	Simple
Short term – Fund Based – Interchangeable (Export Packing Credit)*	Simple
Short term – Fund Based – Interchangeable (Bill Discounting)*	Simple
Long term – Fund Based (Term Loan)	Simple
Short term – Non-Fund Based (Letter of Credit)	Very simple
Short term – Non-Fund Based (Capex Letter of Credit)	Very simple
Long term – Non-Fund Based (Bank Guarantee)	Very simple
Short term – Non-Fund Based (Credit Exposure Limit)	Very simple
Long term/short term – Unallocated limit	Not applicable

**Within the overall fund based working capital limit*

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Cash Credit	NA	NA	NA	60.00	[ICRA]A- (Stable)
NA	Fund Based – Standby Line of Credit	NA	NA	NA	5.00	[ICRA]A2+
NA	Fund Based – Export Packing Credit (Interchangeable)*	NA	NA	NA	(15.00)	[ICRA]A2+
NA	Fund Based – Bill Discounting (Interchangeable)*	NA	NA	NA	(15.00)	[ICRA]A2+
NA	Fund Based – Term Loan	Sep 12, 2014	NA	Jun 30, 2025	8.90	[ICRA]A- (Stable)
NA	Non-Fund Based – Letter of Credit	NA	NA	NA	2.00	[ICRA]A2+
NA	Non-Fund Based – Capex Letter of Credit	NA	NA	NA	10.00	[ICRA]A2+
NA	Non-Fund Based – Bank Guarantee	NA	NA	NA	3.00	[ICRA]A- (Stable)
NA	Non-Fund Based – Credit Exposure Limit	NA	NA	NA	1.00	[ICRA]A2+
NA	Unallocated limit	NA	NA	NA	2.20	[ICRA]A- (Stable) / [ICRA]A2+

Source: *Company; *Within the overall fund based working capital limit*

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

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

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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.

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