Nandan Denim Limited

August 23, 2018

Summary of Rated Instrument:

Instrument	Rated Amount (Rs. crore)	Rating Action
Fund based-Term Loan	470.54	[ICRA]A Reaffirmed; outlook revised to Negative from Stable
Fund based- Working Capital Facilities	274.82	[ICRA]A Reaffirmed; outlook revised to Negative from Stable
Fund based-Working Capital Facilities (Short term)	15.20	[ICRA]A1 Reaffirmed
Non- Fund based facilities	110.00	[ICRA]A1 Reaffirmed
Total	**870.56**	

Material Event

Quarterly results - Q1 FY2019

Nandan Denim Limited has announced its quarterly results on August 13, 2018. The company reported operating income of Rs. 359.6 crore with operating profit (OPBDITA) of Rs. 49.2 crores and Profit after tax (PAT) of Rs. 5.2 crore in Q1FY2019 against operating income of Rs. 424.4 crore with OPBDITA of Rs. 61.9 crore and PAT of Rs. 16.3 crore in Q1FY2018.

Impact of the Material Event

The long-term and short-term ratings remain unchanged at the earlier rating of [ICRA]A/[ICRA]A1, however, the outlook on the long-term rating is revised to Negative from Stable due to continued weaker than expected performance in Q4FY2018 and Q1FY2019.

On a y-o-y basis, the operating income registered de-growth of 15% from Rs. 424.4 crores in Q1FY18 to Rs. 359.6 crores in Q1FY19. Consequently, the operating profitability moderated to 13.69% in Q1FY19 vis-a-vis 14.59% in Q1FY18 and the PAT margins remained at 1.46% in Q1FY19 vis-a-vis 3.84% in Q1FY18. Further, the operating income on a quarterly basis, registered de-growth of ~10% to Rs. 359.6 crore in Q1FY19 compared to Rs. 398.8 crore in Q4FY18, though the operating profitability and PAT margins remained higher.

The previous detailed rating rationale is available on the following link: Click here

Rationale

The revision in rating outlook factors in the moderation in performance of Nandan Denim Limited (NDL) in Q1FY2019, primarily in terms of lower than expected sales which reported a 15% decline compared to the same period last year (Q1FY2018) as well as a 10% decline sequentially (Q4FY2018). Consequently, the profitability and cash accruals remained lower than expectations, due to moderation in scale and inability to adequately pass on the rise in cost and other fixed cost to its customers due to stiff competition and prevalent overcapacity in the denim industry. As per the quarterly results announced on August 13, 2018, NDL reported an operating income of Rs. 359.6 crore, depicting a decline of 15% on Y-o-Y basis. The operating margins also witnessed decline from 14.59%% to 13.69% on Y-o-Y basis. Given the decline in top line in Q1FY2019 and the pressure on margins seen in the last two consecutive quarters (Q4FY2018 and Q1FY2019), the ability of the company to meet revenue expectations for FY2019 and report profitability levels in line with previous fiscal remains to be seen and will be a key rating sensitivity. Further, the ratings continue to be constrained by the inherent cyclicality associated with the textile sector and the prevalent over capacity in the domestic denim industry. The ratings also factor in the vulnerability of profitability to fluctuations in the raw material prices (majorly cotton), moderate return indicators as well as working capital intensive nature of NDL's operations.

Nevertheless, the reaffirmation of the ratings continues to factor in NDL's strong market position as leader in terms of denim capacity in the domestic denim industry, established distribution network and the extensive industry experience of its promoters. The ratings also take comfort from NDL's higher backward integration within the denim value chain which positions it better compared to other competitors and allows the company to better manage its cost structure. ICRA also notes that the capex undertaken in past is eligible for various government incentive schemes which will support profitability going forward, the timely receipt of which remain crucial.

Outlook: Negative

ICRA believes that Nandan Denim Limited (NDL) will continue to benefit from its established presence and experience of its promoters in the denim industry. The outlook may be revised to 'Stable' if the company's performance in terms of returns, coverage indicators and working capital intensity recovers to earlier anticipated levels. The ratings may be downgraded in case of lower than expected growth in scale coupled with further deterioration in profit margins leading to lower than expected cash accruals or in case of any sizeable debt funded capex or stretch in working capital which leads to further stretch in the liquidity position and weakening of the financial profile of the company.

Key rating drivers

Credit strengths

Established market position of NDL as the largest domestic denim manufacturer supported by strong marketing network in domestic markets- The promoters of the NDL, Mr. Vedprakash Chiripal and Mr. Brijmohan Chiripal have more than 40 years of experience in the textile industry. It has an integrated manufacturing unit comprising of production facilities from spinning to fabric finishing in addition to a captive power plant of 15 megawatts (MW). NDL is part of the Chiripal group, which has been present in the textile business since 1972 and has diversified operations in textile value chain with manufacturing of partially-oriented yarn (POY), fully drawn yarn (FDY) and draw texturised yarn (DTY) along with fabric processing.

NDL has an established market position in the Indian denim industry and is the largest denim manufacturer in India with the installed denim capacity of 110 million meters per annum (mmpa). NDL primarily caters to the medium quality denim segment which has a relatively larger market size as compared to the premium denim segment which is mostly targeted to the export markets. NDL has a well-established network of distributors in the domestic market and it enjoys strong relationships with clients across several global markets, which is attributable to the Chiripal group's long-standing presence in the textile business. The company has tie-ups with about 40 distributors across the country including some exclusive distributors for NDL's products.

Backward integrated operations to support the operational risk profile; timely receipts of various eligible incentives under the central and state textile policies remains critical- In order to backward integrate, NDL took periodical to increase its cotton spinning capacity from 40 TPD to 142 TPD, resulting in ~89% of yarn requirement met from in-house spinning unit which positions NDL better compared to other competitors and allows the company to better manage its cost structure and profitability. Further, various sections of NDL's capex are eligible for lucrative incentive schemes for the textile units from the Central and State governments in terms of Interest Subsidy on loan availed, Capital Subsidy on

Plant and Machinery, Value Added Tax (VAT) refund on eligible fixed investment in plant and machinery and exemptions in power tariff.

Credit weaknesses

Weakening in the financial risk profile in Q4FY2018 and Q1FY2019 – On a y-o-y basis, the operating income registered de-growth of 15% from Rs. 424.4 crores in Q1FY18 to Rs. 359.6 crores in Q1FY19. Consequently, the operating profitability moderated to 13.69% in Q1FY19 vis-a-vis 14.59% in Q1FY18 and the PAT margins remained at 1.46% in Q1FY19 vis-a-vis 3.84% in Q1FY18. Further, the operating income on a quarterly basis, registered de-growth of ~10% to Rs. 359.6 crore in Q1FY19 compared to Rs. 398.8 crore in Q4FY18, though the operating profitability and PAT margins remained higher. During Q4FY2018, the operating margins had moderated sharply to 13.35% compared to 16.68% in Q3FY2018 and have continued to remain at sub 14% levels during Q1FY2019 as well. The return indicators of NDL continue to remain moderate with RoCE at 10.7% in FY2018 compared to RoCE at 11.4% in FY2017.

Prevalent overcapacity in the domestic denim industry pressurises realizations - The denim industry has witnessed significant cyclicality in the past, wherein there have been periods of excess capacity in the market as well as periods with tight demand-supply situations. Over the last 4-5 years, denim demand has increased steadily and with a changing production scenario in China, Indian denim players like NDL have increased their capacity and achieved high utilisation. However, with several capacity additions by other players in the recent past and by new players, NDL remains exposed to over-supply situation in the domestic market. Currently, NDL generates majority of its sales from the domestic market and thus its performance will remain exposed to the inherent cyclicality in the denim industry.

Vulnerability of profitability to any adverse fluctuation in key raw material prices - The margins of the company are largely affected by the raw material price fluctuation which in turn affects the sales realisations. Any adverse movement in the price of key raw materials like cotton could have an adverse impact on the company's margins, as the company may not be able to pass on the price hike to its customers owing to high competitive intensity and overcapacity in the industry. ICRA, however, believes that NDL's integrated setup would help to reduce the impact of such adverse movements to some extent.

High working capital intensity resulting from extended receivable period and high inventory levels - The working capital intensity for NDL has remained high at 20-23% for past three years mainly due to high inventory levels emanating from stocking up of cotton inventory during year end with expectations of price increase during lean supply. Thus, company remains susceptible to any unforeseen correction to cotton prices which can lead to inventory losses or on contrary a stable price may lead to higher carrying cost without any foreseen benefits. Further, in the current scenario to push sales, the company also extends higher credit period to support sales, which further increases the working capital cycle.

About the company:

Incorporated in 1994 by Mr. Vedprakash D. Chiripal and Mr. Brijmohan Chiripal, Nandan Denim Limited (NDL) (earlier known as Nandan Exim Limited) was initially engaged in manufacturing, trading and export of textile products – primarily denim products. The company is a part of the Chiripal group, which is based in Ahmedabad (Gujarat), having presence in various industries such as textiles, education, real estate, packaging and chemicals.

The company forayed into manufacturing operations in FY2004 with a project for weaving of denim fabric and the commercial production of 20 million meters per annum (MMPA) capacity of denim fabric was commenced in FY06. With periodic expansions, the installed capacity of denim manufacturing now stands at 110 MMPA. Denim fabrics manufactured by NDL are either made up of 100% cotton yarn or mixed with Lycra, Polyester, etc in weft depending upon the market requirement. NDL also backward integrated by installation of a cotton spinning unit of 40TPD capacity in FY11, which stands increased to 142 TPD in current fiscal. Further, NDL diversified its portfolio by setting up a 10 million meters per annum shirting capacity in March 2014. The company also operates a 15 MW power plant within its premises which meets its entire power requirements. NDL has its manufacturing facilities located at Sejpur-Gopalpur at Ahmedabad.

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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.

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