June 04, 2019

Nandan Denim Limited- Update on Material Event; Ratings downgraded to [ICRA]A-(Negative)/[ICRA]A2+

Summary of Rated Instrument:

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Fund-based Term Loan	390.35	390.35	Revised to [ICRA]A-(Negative) from [ICRA]A(Negative)
Fund-based Working Capital Facilities	249.80	249.80	Revised to [ICRA]A-(Negative) from [ICRA]A(Negative)
Fund- based Working Capital Facilities (Short term)	15.20	15.20	Revised to [ICRA]A2+ from [ICRA]A1
Non- fund based facilities	80.00	80.00	Revised to [ICRA]A2+ from [ICRA]A1
Total	**735.35**	**735.35**	

Material Event

Quarterly Results – Q4 FY2019 and Annual results- FY2019

Nandan Denim Limited has announced its quarterly results of Q4FY2019 and annual results of FY2019 on May 25, 2019. The company reported operating income(OI) of Rs. 389.4 crore with operating profit (OPBDITA) of Rs. 37.0 crores and Profit after tax (PAT) of Rs. 4.1 crore in Q4FY2019 against an operating income of Rs. 398.8 crore with OPBDITA of Rs. 53.2 crore and PAT of Rs. 0.8 crore in Q4FY2018. On a yearly basis the company registered ~8% de-growth in OI to Rs. 1469 crore in FY2019 compared to Rs. 1589 crore in FY2018, with operating profit margins and net profit margins remaining weaker at 11.11% and 1.50% respectively in FY2019 compared to 14.17% and 2.94% in FY2018 respectively.

Impact of the Material Event

The long-term and short-term ratings are revised to [ICRA]A-(Negative)/[ICRA]A2+ from [ICRA]A(Negative)/[ICRA]A1 due to continued weaker than expected performance in Q4FY2019 and FY2019. On a y-o-y basis, the operating income registered de-growth of 2.3% from Rs. 398.8 crores in Q4FY2018 to Rs. 389.4 crores in Q4FY2019, with the operating profitability moderating to 9.50% in Q4FY2019 vis-a-vis 13.35% in Q4FY2018. Further, though the operating income registered a growth of 13.6% to Rs. 389.4 crore in Q4FY2019 compared to Rs. 342.7 crore in Q3FY2019, the operating profitability and PAT margins have moderated to 9.50% and 1.05% respectively compared to 11.29% and 1.41% respectively in Q3FY2019. Further, on a yearly basis the company registered ~8% de-growth in OI to Rs. 1469 crore in FY2019 compared to Rs. 1589 crore in FY2018, with operating profit margins and net profit margins remaining weaker at 11.11% and 1.50% respectively in FY2019 compared to 14.17% and 2.94% in FY2018 respectively.

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

Rationale

The ratings revision takes into account lower than expected growth in scale and moderation in profit margin over the last few quarters, resulting in lower than expected cash accruals for FY2019 and going forward. NDL has witnessed moderation in sales volume and average denim realisations have also declined from Rs. 131 per metre in FY2018 to Rs. ~123 per metre in FY2019 despite increase in average raw material prices because of the stiff competition and prevalent overcapacity in the denim industry. As compared to the operating margin of ~14.17% in FY2018, the operating margin declined to 11.11% in FY2019. 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), average return indicators as well as working capital intensive nature of NDL's operations.

The industry headwinds are off-set to some extent by NDL's strong market position as leader in terms of denim capacity in the domestic denim industry, superior product portfolio, established distribution network and the extensive industry experience of its promoters. The ratings 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. The ratings also take comfort from NDL's adequate liquidity position with expected net cash accruals to remain comfortable to meet the scheduled debt repayments.

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 substantial growth in revenues coupled with revival in profitability and better working capital intensity, strengthen the financial risk profile. 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 a stretch in working capital which leads to stretch in the liquidity position and weakening of the financial profile of the company.

Key rating drivers

Credit strengths

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

NDL has an established market position in the Indian denim industry and is one of the largest denim manufacturers in India, with an installed denim capacity of 110-million metres per annum (mmpa). NDL primarily caters to the medium quality denim segment, which has a larger market size than 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 enjoys strong relationship with clients in several global markets, attributable to the Chiripal Group's long presence in the textile business. The company has tie-ups with about 40 distributors across the country, including some exclusive distributors.

Backward integrated operations to support operational risk profile; timely receipts of various eligible incentives under central and state textile policies remains crucial- In order to backward integrate, NDL took periodical to increase its cotton spinning capacity to 142 TPD from 40 TPD. At present, ~89% of yarn requirement is met from in-house spinning unit. This enables NDL to better manage its cost structure and profitability that its competitors. Further, various sections of NDL's capex are eligible for lucrative Central and state government's incentive schemes such as interest subsidy on loan availed, capital subsidy on plant and machinery(P&M), value added tax (VAT) refund on eligible fixed investment in machinery P&M and exemptions in power tariff, meant for textile units.

Healthy financial risk profile– The financial risk profile remains healthy, marked by a strong net worth base of ~Rs. 492 crore, gearing of 1.2 times as on March 31, 2019, and an adequate liquidity position.

Credit challenges

Weakening in profitability and return indicators– The company's operating profit moderated to 11.11% in FY2019 from 14.17% in FY2018 due to erosion in denim realisations and volumes. Consequently, the net profit margin also declined to 1.50% in FY2019 from 2.94% in FY2018. The return indicators of NDL weakened with RoCE at 5.3% for FY2019 compared to 10.8% in FY2018, due to decline in profitability.

Prevalent over-capacity in domestic denim industry pressurises realisations - 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 four to five years, denim demand has increased steadily and several Indian denim players such as NDL have increased their capacity under the prevailing government incentive scheme. However, with several capacity additions in the recent past, denim supply has exceeded the demand growth, exposing NDL to an over-supply situation in the domestic market. The company's average realisation from denim fabric moderated and remained at Rs. 123 per metre in FY2019 compared to Rs. 131 per metre in FY2018. 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 adverse fluctuations 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 competition 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 - The working capital intensity for NDL has remained high and has further increased to 30% in FY2019 due to reduction in creditor days and high inventory and debtor days. The inventory remains high due to stocking of cotton during year end with expectations of price increase during lean supply. Thus, on one hand, the company remains susceptible to unforeseen corrections to cotton prices, which can lead to inventory losses. On the other hand, a stable price may lead to higher carrying cost without any foreseen benefits. The overall levels remained high compared to ICRA estimates due to increase in short-term debt during FY2019-end following increase in working capital requirements.

Liquidity position

Cash flow from operations continues to remain positive, while the free cash flows remained negative in FY2019 with repayments. The overall liquidity position of the company remains adequate marked by sufficient cash accruals (though it has moderated due to moderation in profitability) against debt obligations.

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 exporting of textile products—primarily denim products. The company is a part of the Ahmedabad-based Chiripal Group, which has 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 metres per annum (MMPA) capacity of denim fabric was commenced in FY2006.

With periodic expansions, the installed capacity of denim manufacturing now stands at 110 MMPA. Denim fabrics manufactured by NDL are either made of 100% cotton yarn or mixed with Lycra, Polyester, and so on in weft, depending on the market requirement. NDL underwent backward integration and installed a cotton spinning unit of 40TPD capacity in FY2011, which now stands at 142 TPD in the current fiscal. Further, NDL diversified its portfolio by setting up a 10-million metre per annum shirting capacity in March 2014. The company also operates a 15-MW power plant within its premise, which meets its entire power requirements. NDL's manufacturing facility is located at Sejpur-Gopalpur in Ahmedabad.

In FY2019, the company reported a net profit of Rs. 22.1 crore on an operating income of Rs. 1469.3 crore, compared to a net profit of Rs. 46.7 crore on an operating income of Rs. 1588.9 crore in the previous year.

Key financial indicators (audited)

	FY2018	**FY2019**
Operating Income (Rs. crore)	1589	1469
PAT (Rs. crore)	47	22
OPBDIT/OI (%)	14.2%	11.1%
RoCE (%)	10.8%	5.3%
Total Debt/TNW (times)	1.3	1.2
Total Debt/OPBDIT (times)	2.8	3.7
Interest coverage (times)	3.9	6.0

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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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