October 04, 2019

Suraj Industries: Rating 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	33.00	[ICRA]BBB+(Stable); reaffirmed
Bank Guarantee	2.00	2.00	[ICRA]A2+; 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 entities, namely SRV Synthetics (SRVS), SRV Polytex Private Limited (SRVPPL) and Suraj Industries (SI), given their strong operational and financial linkages, presence in similar business 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 also derives comfort from the steady improvement in the operating margin, given its increasing focus on high value-added yarn, coupled with forward integration into fabric knitting and accompanying fiscal benefits under the Technology Upgradation Fund Scheme (TUFS). Further, despite the debt-funded capex, the Group's capital structure and coverage indicators continue to remain comfortable due to equity infusion, which entails a strong net worth base and healthy cash accruals in the business.

The rating, however, remains constrained by the vulnerability SRV Group's operating income (OI) to cyclicality inherent in the textile industry, which has impacted the revenue growth in FY2019. 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 also 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 which will be supported by the increase in order inflow following the forward integration into fabric knitting and improvement in profit margins due to captive consumption of raw materials.

Key rating drivers and their description

Credit strengths

Extensive industry experience of the key promoters spanning over two decades 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 market. Over the years, the Group has undertaken technological upgradation in its manufacturing facility to be able to comply with the latest consumer requirements that enhances credibility.

Expanding distribution network coupled with geographically diversified and established client base – SRV Group manufactures yarn, which is sold through more than 200 agents with direct billing in the name of the customer. 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 SRV Synthetics. However, exports remained low in the range of 5-10% of the total sales over the last three years.

Sustained operating profitability marked by captive consumption of raw material (yarn) along with forward integration into fabric knitting; accompanying fiscal benefits in the form of TUFS – Over the years, the Group has increased its focus towards manufacturing high value-add yarn, which accounts for most of the 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 ventured into the manufacturing of greige knitted fabric, which is primarily used in the hosiery industry. It has begun captive consumption of this yarn, which has resulted in a sustained growth of 5.7% in the operating profitability in FY2019 (P) from 5.0% in FY2018. 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 financial profile as exhibited by favourable capital structure supported by equity infusion and satisfactory debt metrics – Despite the large debt-funded capex of Rs. 44.67 crore undertaken in FY2019 for the installation of 100 knitting machines, the capital structure of the Group remained comfortable with a gearing level of 0.5 time as on March 31, 2019, which improved from 0.6 time as on March 31, 2018. The improvement in capital structure was mainly on account of equity infusion to the tune of ~Rs. 17.5 crore, which resulted in low utilisation of the working capital limits as well as repayment of unsecured loans in the business in FY2019. Aided by declining debt levels as well as improvement in profitability, the coverage indicators as reflected by OPBDITA/Interest improved to 4.1 times and Total debt/OPBDITA to 2.5 times in FY2019 from 3.8 times and 2.9 times, respectively, in FY2018.

Credit challenges

Susceptibility of operating revenues and profitability to cyclicality inherent in the textile industry; profitability margins vulnerable to volatility in raw material costs – An overall slowdown in the economy coupled with delay in the new project implementation and captive consumption of yarn, resulted in degrowth in revenues to Rs. 375.9 crore in FY2019 from
Rs. 386.9 crore in FY2018. The prices of the key raw material POY (manufactured using PET Chips), being a crude oil derivative, witnessed an increase in prices in FY2019 owing to rising crude oil prices. While the price of POY was in the range of Rs. Rs. 94-132/kg, it rose to Rs. 103-149/kg in FY2019. 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 such as capital withdrawals, insolvency and death of partners – 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 market. 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

The Group infused equity amounting to ~Rs. 17.5 crore in FY2019 to facilitate the capex as well as reduce the dependence working capital loans which resulted in low utilisation of the same with an undrawn limit of Rs. 22.30 crore as on March 31, 2019. Further, the debt repayment remains modest at Rs. 6.53 crore in FY2020.

ICRA assesses, the Group's liquidity position is expected to remain adequate as a result of improved profitability post the capex which will translate into healthy net cash accruals. Although heavy capex has kept the free cash flow position negative.

Rating sensitivities

Positive triggers: ICRA could upgrade SRV Group's rating if it demonstrates an improvement in the scale of operations translating into healthy return on capital employed, while maintaining an interest coverage ratio of above 5.0 times and Total Debt/OPBDITA of below 2.25 times on a sustained basis.

Negative triggers: Negative pressure on rating could trigger if interest coverage ratio deteriorates below 3.3 times and Total Debt/OPBDITA rises above 3.0 times.

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 the manufacturing of texturised yarn and high value-added yarn in deniers ranging between 80 and 600, with the denier mix being determined by the profitability available for the respective deniers. The firm has diversified its operations by way of forward integration into manufacturing greige knitted fabrics 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 SRV Synthetics (rated [ICRA]BBB+(Stable)/[ICRA]A2+ in September 2019), SRV Polytex Private Limited[1] and Suraj Industries. While SRVPPL is just an investment arm, SRVS and SI are engaged in the business of manufacturing high value-added yarn in deniers ranging between 80 and 600 and greige knitted fabrics.

In FY2019 (P), the Group reported a profit after tax (PAT) of Rs. 2.9 crore on an OI of Rs. 375.9 crore, as compared to a net PAT of Rs. 8.2 crore on an OI of Rs. 386.9 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

	FY2018 Audited	FY2019 Provisional (P)
Operating Income (Rs. crore)	386.9	375.9
PAT (Rs. crore)	8.2	2.9
OPBDIT/ OI (%)	4.8%	5.7%
RoCE (%)	13.7%	8.2%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	0.6
Total Debt/OPBDIT (times)	2.9	2.5
Interest Coverage (times)	3.8	4.1
DSCR	2.3	2.7

Source: SI

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					4-Oct-2019	12-Jul-2018	10-Apr-2017	06-Apr-2016
1	Cash credit	Long Term	30.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Term loans	Long Term	33.00	32.01	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Bank Guarantee	Short Term	2.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+

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 www.icra.in

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	2018	9.55%	2027	33.00	[ICRA]BBB+(Stable)
NA	Bank Guarantee				2.00	[ICRA]A2+

Source: SI

Annexure-2: List of entities considered for consolidated analysis:

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

ANALYST CONTACTS

K. Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Srinivas Menon
+91 22 61693354
srinivas.menon@icraindia.com

Vidhi Vasa
+91 22 6169 3352
vidhi.vasa@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:

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
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