October 31, 2022

Sri Shanmugavel Mills Private Limited: Ratings reaffirmed; rated amount enhanced; removed from watch with developing implications and Stable outlook assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	16.11	95.12	[ICRA]BBB+(Stable) reaffirmed/ assigned to the enhanced limits; rating removed from watch with developing implications and Stable outlook assigned
Long-term Fund-based Cash Credit	90.00	215.00	[ICRA]BBB+(Stable) reaffirmed/ assigned to the enhanced limits; rating removed from watch with developing implications and Stable outlook assigned
Short-term Non-fund based Working capital facilities	30.00	40.00	[ICRA]A2; reaffirmed/ assigned to the enhanced limits
Long-term/Short-term Unallocated	108.89	149.88	[ICRA]BBB+(Stable)/[ICRA]A2; reaffirmed/ assigned to the enhanced limits; rating removed from watch with developing implications and Stable outlook assigned
Total	**245.00**	**500.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating action considers the conclusion of the business restructuring of the erstwhile SSM Group[1]. The National Company Law Tribunal (NCLT) order approving the business restructuring within the erstwhile SSM Group had been received in April 2022. As a part of the restructuring exercise, the assets and liabilities of the erstwhile SSM Group companies have been reallocated among them in varying proportions. Based on the transfer of assets and liabilities as a part of the scheme, Sri Shanmugavel Mills Private Limited's capacity and scale of operations have increased upon the implementation of the revised structure. The ratings also factor in the steady operational and financial performances of Sri Shanmugavel Mills Private Limited (SSMPL or the company) in FY2022, supported by its established presence in the medium and coarser-count hosiery yarn market in Tamil Nadu. While the performance is likely to witness some moderation in FY2023, given the adverse operating environment in the cotton spinning industry, the conservative capital structure of the company, extensive experience of the promoters, its established market position, long relationships with customers, and favourable demand conditions over the long term to provide comfort. The ratings also factor in the operational synergies enjoyed by the company in terms of centralised raw material sourcing and distribution system, being a part of companies under the resultant Group[2].

The ratings are, however, constrained by the commoditised nature of the company's products, which, coupled with the fragmented industry structure result in limited pricing power, keeping profitability under check. Further, the ratings factor in

[1] *The eight companies which are referred to as the erstwhile SSM Group include: (a) Sri Shanmugavel Mills Private Limited, (b) Sudhan Spinning Mills Private Limited, (c) Sivaraj Spinning Mills Private Limited, (d) Adisankara Spinning Mills Private Limited, (e) Sri Velayudhaswamy Spinning Mills Private Limited, (f) Prabhu Spinning Mills Private Limited, (g) Vedha Spinning Mills Private Limited, and (h) Sri Matha Spinning Mills Private Limited*

the high working capital intensity of SSML's operations due to the seasonal nature of cotton availability that requires stocking during the harvest season, keeping the profitability vulnerable to the volatility in cotton prices.

While reaffirming the ratings, ICRA has taken note of the large debt-funded inorganic growth plans of the company. While the expansion would strengthen the SSML's market position and support its growth targets over the medium to long term, a sizeable increase in debt levels would have an adverse impact on the leverage indicators over the medium term. Nevertheless, the credit profile continues to take comfort from the expected adequate cash flows and coverage metrics over the next three fiscals, with the minimum debt service coverage ratio (DSCR) expected to be at around 1.6 times.

The Stable outlook on the rating reflects ICRA's opinion that the SSML's operating performance will benefit from its established market position, and its long relationships with key customers aiding repeat orders. Further, the expected recovery in the demand conditions from Q4 FY2023, along with the moderation in cotton prices, would aid the operating performance over the medium term.

Key rating drivers and their description

Credit strengths

Operational synergies being a part of the resultant Group – SSML enjoys operational synergies being a part of the companies under the resultant Group[2] post the business restructure, with the cotton procurement and order sourcing continuing to be 2haracteriz, at present. The Group is among the largest textile groups in South India, with sizeable capacities in the spinning and fabric segments. The Group is the leading supplier of the medium and coarser-count hosiery yarn market in Tamil Nadu (which includes the large hosiery hub in Tirupur) and enjoys an established presence across other key domestic and export markets.

Comfortable financial profile – SSML's financial profile remains comfortable, 2haracterized by adequate leverage indicators and coverage metrics. Key metrics such as total debt to operating profits and DSCR were at 2.4 and 2.6 times, respectively, in FY2022. SSML is expanding its capacities at a total cost of ~Rs. 110 crore, by acquisition of a spinning unit by the way of a slump sale. The capital investment will be largely debt-funded, with 80% through term loans from banks, the leverage indicators are expected to moderate over the near to medium term. ICRA expects SSML's leverage metrics, including gearing and total debt to operating profits (TD/OPBDITA), likely to increase to peak levels of around 0.9 times and 4.4 times, respectively, in FY2023, and then improve in the subsequent fiscals as the capacities start generating earnings. Further, earnings are exposed to execution and demand-related risks. Despite these risks, an expected improvement in the business profile, along with the estimated comfortable coverage metrics and liquidity position, lend comfort.

Large scale of operations and integrated nature of business to support the operating performance over the medium term - SSML's operating performance in FY2022 was supported by the favourable demand conditions, wherein its revenues grew by 66%. The performance in the current fiscal is likely to be constrained by the weak spinning industry scenario. The subdued yarn demand and prices are likely to put pressure on the overall sales volumes for FY2023, resulting in a moderation in revenues. However, with the proposed spinning unit acquisition, which is expected to be completed by November 2022, the operating performance is likely to improve over the medium term with healthy capacity utilisation of ~90% from April 2024.

Credit challenges

Working capital-intensive operations; susceptibility to volatility in cotton and cotton yarn prices – SSML operates in a highly competitive and commoditised spinning industry, characterised by minimal product differentiation and fragmentation, which restrict the pricing flexibility. In addition, the requirement of stocking cotton during the harvest season makes the operations working capital intensive and exposes the profitability to fluctuations in cotton prices. Firm cotton prices and pressure on yarn

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[2] *The five companies under the resultant Group include: (a) Sri Shanmugavel Mills Private Limited, (b) Sudhan Spinning Mills Private Limited, , (c) Vedha Spinning Mills Private Limited, (d) Sri Lalithambighai Textiles Private Limited and (e) Sri Matha Spinning Mills Private Limited*

realisations had constrained the contribution levels in the past. However, SSML's earnings have been protected to an extent by the operational advantages, such as centralised cotton procurement for the Group's companies.

Moderate operating profitability - The spinning and knitting industries are highly fragmented with a significant share of the unorganised segment. The company's product portfolio continues to be concentrated towards medium and coarser-count yarns, which entails relatively lower value addition. As a result, it enjoys limited pricing power, which is likely to keep its profitability under check. Margins over the years have been supported to an extent by the captive power generation and focus on cost savings.

Liquidity position: Adequate

SSML's liquidity position is expected to remain adequate, supported by steady earnings from operations and adequate unutilised lines of credit. Average utilisation of its fund-based limits over the last 12-month period ending August 2022 was moderately high at around 75%. Cash buffer, including unutilised lines of credit, was at around Rs. 60 crore as on August 31, 2022. Further, SSMPL's funding requirements towards debt repayment obligations are estimated to be at ~Rs. 25 crore in the current fiscal, against comfortable earnings from operations estimated for the period.

Rating sensitivities

Positive factors – The ratings may be upgraded, upon timely commissioning of the projects without any cost overruns and successful ramping up of the facilities, which, in turn would support improvement in credit metrics and liquidity position. Key credit metrics that would be required for an upgrade include TD/OPBDITA reducing to less than 2 times, on a sustained basis.

Negative factors – The ratings may be downgraded, upon any material time or cost overruns or sub-optimal utilisation of new capacities upon commissioning, which will adversely impact the credit profile. Further, any sustained pressure on revenues and earnings or deterioration of its working capital cycle, which would adversely impact the credit metrics and liquidity position could also result in a downgrade. A specific credit metric for a downgrade is if DSCR reduces to less than 1.6 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textile Industry - Spinning
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the rating, ICRA has standalone financial statements of Sri Shanmugavel Mills Private Limited

About the company

Sri Shanmugavel Mills Private Limited (SSMPL), was set up in 1980 and manufactures cotton yarn and knitted fabric. The spinning division of SSMPL produces counts ranging from 28s to 50s (with average counts of 30s+ being produced). A bulk portion of the yarn manufactured by the company finds its application in the knitting fabric segment. As a part of the business restructuring within the SSM Group, SSML had filed a scheme of arrangement with the National Company Law Tribunal (NCLT). Post the restructuring, the company has 1,03,440 spindles, 768 Rotors, 338 knitting machines and windmills of 31.75 MW. Prior to the restructuring, SSML had an installed capacity of 48,336 spindles, 960 rotors, one knitting machine, 240 looms and windmills capacity of 23.70 MW.

Key financial indicators (provisional)

Standalone	FY2021	FY2022
Operating income	792.3	1,314.5
PAT	-1.1	43.7
OPBDIT/OI	8.4%	8.5%
PAT/OI	-0.1%	3.3%
Total outside liabilities/Tangible net worth (times)	1.1	1.3
Total debt/OPBDIT (times)	3.7	2.4
Interest coverage (times)	4.4	5.1

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. crore

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 Sept 30, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		Date & rating in FY2020	
					Oct 31, 2022	Sep 24, 2021	Sep 28, 2020	May 04, 2020	Feb 07, 2020	Jun 05, 2019
1	Term loan	Long term	95.12	95.12	[ICRA]BBB+ (Stable)	[ICRA]BBB+ &	[ICRA]BBB+ @	-	-	-
2	Working capital facility	Long term	215.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ &	[ICRA]BBB+ @	[ICRA]A-@	[ICRA]A@	[ICRA]A+@
3	Non-fund based facility	Short term	40.00	-	[ICRA]A2	[ICRA]A2&	[ICRA]A2@	[ICRA]A2+ @	[ICRA]A2+@	[ICRA]A1@
4	Unallocated facility	Long term/ short term	149.88	-	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ &/ [ICRA]A2&	[ICRA]BBB+ @/ [ICRA]A2@	[ICRA]A-@ /[ICRA]A2+ @	[ICRA]A@ /[ICRA]A2+ @	[ICRA]A+@ /[ICRA]A1@

&= Under Watch with Developing Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loan	Simple
Working capital facility	Simple
Non-fund based facility	Very Simple
Unallocated facility	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	Term Loan	FY2021	-	FY2026	95.12	[ICRA]BBB+(Stable)
NA	Cash Credit	-	-	-	215.00	[ICRA]BBB+(Stable)
NA	Letter of Credit	-	-	-	40.00	[ICRA]A2
NA	Unallocated facility	-	-	-	149.88	[ICRA]BBB+(Stable)/[ICRA]A2

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

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Kaushik Das
+91 33 71501104
kaushikd@icraindia.com

Sahil Udani
+91 22 6114 3429
sahil.udani@icraindia.com

Roshan Dugar
+91 40 4596 4326
roshan.dugar@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

Registered Office

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

Branches