

January 17, 2023

Aarti International Limited: [ICRA]A- (Stable)/ [ICRA]A2+ assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
LT fund-based cash credit	278.40	[ICRA]A- (Stable); assigned
LT fund-based term loan	201.49	[ICRA]A- (Stable); assigned
LT/ST non-fund based limits	27.30	[ICRA]A- (Stable)/[ICRA]A2+; assigned
LT/ST unallocated limits	12.81	[ICRA]A- (Stable)/[ICRA]A2+; assigned
Total	520.00	

*Instrument details are provided in Annexure-1

Rationale

ICRA has assigned a long-term rating of [ICRA]A- (Stable), and a short-term rating of [ICRA]A2+ to Aarti International Limited (AIL). The ratings assigned derive comfort from AIL's long track record of more than 28 years in the spinning business, its large-scale operations with a single-location spinning capacity of 1.8 lakh spindles, a wide product portfolio of basic and value-added yarn and partial forward integration into knitting and fabric processing. Further, comfort can be drawn from its consistently healthy capacity utilisation levels of around 97-99%, which provide benefits of economies of scale. ICRA expects the capacity utilisation to remain at healthy levels, going forward as well.

Over the years, AIL has been successful in ramping up its operations, which led to healthy revenue increase at CAGR of 16% during FY2017-FY2022. Given the weak demand scenario and uncompetitive Indian prices, the revenues for FY2023 are expected to remain muted. While the margins are 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, long relationships with customers, and favourable demand conditions over the long term, provide comfort.

The ratings are, however, constrained by the commoditised nature of the company's products, which, coupled with the fragmented industry structure, results in limited pricing power, keeping profitability under check. Further, the ratings factor in the high year-end working capital intensity of AIL's operations, due to the seasonal nature of cotton availability that requires stocking during the harvest season, keeping the leverage high and profitability vulnerable to the volatility in cotton prices. Moreover, as AIL continues to derive ~30-35% of its revenues from exports (though the dependence upon exports has declined considerably from past levels), the earnings remain dependent on its ability to effectively hedge its export receivables, on a consistent basis, besides the demand trend in the export markets.

The Stable outlook reflects ICRA's opinion that AIL's credit profile is likely to remain comfortable, despite a likely moderation in the operating margin, going forward, from the current elevated level. 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. While an ~Rs. 140-crore capex envisaged in the near to medium term is unlikely to materially impact the company's liquidity and capital structure, the same is likely to enhance AIL's scale of operations and value addition, going forward.

Key rating drivers and their description

Credit strengths

Large-scale spinning operations with an established market position and sizeable presence in value-added products – AIL is a Ludhiana-based spinner with a single-location capacity of 1.8 lakh spindles, which is large compared with an average capacity of ~28,000-30,000 spindles per unit in India. The large scale in yarn manufacturing augurs well for its cost structure in a

commoditised market. The company manufactures pure cotton and blended spun yarn across a wide count range, with 30s and 32s counts accounting for a predominant portion of the production. In addition to the basic grey yarn, it also manufactures value-added yarn. The ability to manufacture a diversified product range across various counts and varieties not only improves its value addition, but also provides AIL with the flexibility to switch among its product offerings, depending upon the demand scenario. Further, its forward integration into knitting and fabric processing increases the value addition and diversification, while moderating the impact of the cyclical nature in the spinning industry.

Healthy operational performance, corroborated by consistently high utilisation of the spinning mill – Given its established market position in the industry with extensive relationships with clients and a value-added product profile, AIL's spinning unit's production levels have remained healthy, with more than 95% capacity utilisation in most years. In addition, AIL's capacity utilisation in the spinning division has been partially supported by increased captive consumption in the knitted fabrics division in the recent years. This is corroborated by a healthy capacity utilisation of ~99% in the company's spinning division in FY2022. The capacity utilisation level remained healthy at ~97% in 7M FY2023. ICRA notes that the capacity utilisation of AIL's fabric division improved on a YoY basis and stood at ~74% in FY2022. ICRA expects the capacity utilisation to remain at healthy levels for the spinning division, going forward as well, and the utilisation for the fabric division to ramp-up in the near to medium term.

Healthy financial risk profile – AIL's financial risk profile has improved over the years, marked by healthy scale of operations and profit margins, leading to accumulation of a healthy net-worth base. AIL reported a healthy operating performance in FY2022, with the company posting an all-time high operating income (OI) of Rs. 1,416.9 crore on the back of a sharp rise in yarn realisations. Its operating profit margin (OPM) also remained healthy at 22.2%, supported by healthy contribution levels. AIL's capital structure and coverage indicators have remained comfortable with a gearing of 0.8 times as on March 31, 2022, and interest coverage and total debt/OPBIDTA of 8.1 times and 1.5 times, respectively, in FY2022. Given the sizeable debt-funded capex planned in FY2023, the capital structure and coverage indicators are expected to moderate in the current year from the FY2022 level; however, still expected to remain at healthy levels.

Credit challenges

Leveraged capital structure despite healthy net-worth base, due to high year-end working capital requirements – Given the fixed as well as working capital-intensive nature of operations, AIL's financial leverage, similar to other domestic spinning companies, has remained high over the years. AIL has incurred significant debt-funded capex in FY2022 and FY2023 (~Rs. 242 crore) towards expansion, upgradation and maintenance of its facilities and solar power projects. This has led to a sharp increase in debt outstanding on its books, which is likely to moderate coverage metrics at FY2023-end. Further, the year-end debt and working capital intensity level, which is high due to higher cotton stocking during the harvest season (inventory level peaks in March) continues to moderate the capital structure and coverage metrics towards the year end. However, ICRA notes that the company's capex plans in the near term and availability of significant liquidity, would aid in meeting debt repayment obligations as well as the near-term commitments.

Susceptibility to volatility in cotton and cotton yarn prices, and currency movements – Similar to other entities in the spinning sector, AIL stocks cotton during the harvest season from October to March. This practice exposes it to the fluctuations in cotton and, hence, cotton yarn prices during the non-harvest period as the procurement cost for AIL becomes fixed. This results in high dependence on working capital borrowings and keeps the leverage high, particularly at the year end. Further, as it derives about 25-30% of its revenues from exports, AIL's profitability remains dependent on its ability to effectively hedge its export receivables, on a consistent basis, and on the demand in the export markets.

Commoditised nature of yarn, coupled with fragmented industry structure, keeps profitability under check – The spinning and knitting industries are highly fragmented with a significant share of the unorganised segment. While AIL manufactures a wide variety of products, encompassing yarns with varying levels of value addition and knitted fabrics, its product portfolio continues to be concentrated towards medium-count and low-to-medium value-added yarns and fabrics. As a result, it enjoys limited pricing power, which is likely to keep its profitability under check.

Liquidity position: Adequate

AIL's liquidity position is adequate, with free cash and cash equivalents of ~Rs. 50 crore as on January 5, 2023. Further, the fund-based limits have adequate buffer of ~80%, with an average utilisation of ~20% on the sanctioned lines during the nine-month period ending December 2022. Overall, ICRA expects AIL to be able to meet its near-term commitments through internal as well as external sources.

Rating sensitivities

Positive factors – The ratings could be upgraded, if the company reports a healthy improvement in its scale of operations, along with a sustained recovery in its profitability, which results in an improvement in its return and debt protection metrics. Further, efficient working capital management, which improves AIL's liquidity position could be a positive rating trigger. A specific credit metric for an upgrade is if ROCE is more than 16%, on a sustained basis.

Negative factors – The ratings could witness a downward revision, if any sharp decline in revenues and profits or any large debt-funded capex adversely impacts its credit metrics or liquidity position. Specifically, AIL's interest cover remaining below 4 times, on a sustained basis, would be a negative factor.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology - Textiles Industry (Spinning) Rating Methodology - Textiles Industry (Fabric Making)
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

AIL, incorporated in 1993, is a Ludhiana-based vertically integrated manufacturer of ring-spun yarns and knitted fabrics. The company has a large single-location spinning capacity of 1.80 lakh spindles, whereby it manufactures cotton and blended spun-yarns, with a focus on medium counts. To achieve partial forward integration, AIL forayed into fabric knitting with the commissioning of 15 knitting machines in FY2017. The company has, thereafter, installed a fabric processing capacity and has enhanced to 121 knitting machines with about 25 MT per day fabric knitting capacity. AIL also has rooftop solar installation of ~11 MW and two fully functional MLD ZLD ETP (Minimal Liquid Discharge & Zero Liquid Discharge Effluent Treatment Plants), with 92% of Recovery of Water.

AIL is part of the Ludhiana-based Aarti Group that also has interests in iron and steel business through Aarti Steels Limited (ASL)¹, which manufactures sponge iron, steel billets/ingots, rounds and bars, steel wires and ferro alloy.

¹ ASL's bank facilities are rated [ICRA]A+(Stable)/[ICRA]A1. For detailed rating rationale, please refer to ICRA's website – www.icra.in

Key financial indicators

	FY2021	FY2022
Operating Income (Rs. crore)	813.7	1,416.9
PAT (Rs. crore)	35.3	185.3
OPBDIT/OI (%)	13.1%	22.2%
PAT/OI (%)	4.3%	13.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.1
Total Debt/OPBDIT (times)	3.7	1.5
Interest Coverage (times)	3.5	8.1

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Source: AIL

Status of non-cooperation with previous CRA: Brickwork ratings has moved the rating to BWR BBB+/Stable/A2 issuer not cooperating category on December 23, 2022.

Any other information: Not applicable

Rating history for past three years

S. No	Instrument	Type	Current rating (FY2023)		Chronology of Rating History for the past 3 years			
			Amount rated (Rs. crore)	Amount outstanding as of November 30, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Jan 17, 2023	Jan 3, 2022	Nov 23, 2020	Jan 24, 2020
1	Fund-based cash credit	Long Term	278.40	--	[ICRA]A-(Stable)	[ICRA]BBB+(Stable); Withdrawn	[ICRA]BBB+(Stable)	[ICRA]A-(Negative)
2	Fund-based term loan	Long Term	201.49	120.25	[ICRA]A-(Stable)	[ICRA]BBB+(Stable); Withdrawn	[ICRA]BBB+(Stable)	[ICRA]A-(Negative)
3	Non-fund based limits	Long-Term/Short Term	27.30	--	[ICRA]A-(Stable)/[ICRA]A2+	--	--	--
4	Unallocated limits	Long-Term/Short Term	12.81	--	[ICRA]A-(Stable)/[ICRA]A2+	--	--	--
5	Bank Guarantee	Long-Term	--	--	--	[ICRA]BBB+(Stable); Withdrawn	[ICRA]BBB+(Stable)	[ICRA]A-(Negative)
6	Unallocated Limit	Long-Term	--	--	--	[ICRA]BBB+(Stable); Withdrawn	[ICRA]BBB+(Stable)	[ICRA]A-(Negative)
7	Letter of Credit	Short-Term	--	--	--	[ICRA]A2; Withdrawn	[ICRA]A2	[ICRA]A2+
8	Long-term/Short term Interchangeable	Long-Term/Short Term	--	--	--	[ICRA]BBB+(Stable)/[ICRA]A2; Withdrawn	[ICRA]BBB+(Stable)/[ICRA]A2	[ICRA]A-(Negative)/[ICRA]A2+

Complexity level of the rated instrument

Instrument	Complexity Indicator
LT - Fund based - Term Loans	Simple
LT - Fund based - Cash Credit	Simple
LT/ST - Non-fund based limits	Very Simple
LT/ST - Unallocated	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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	LT - Fund based - Term Loans	FY2015-FY2023	6.0%	FY2024-FY2030	201.49	[ICRA]A- (Stable)
NA	LT - Fund based - Cash Credit	NA	NA	NA	278.40	[ICRA]A- (Stable)
NA	LT/ST - Non-fund based limits	NA	NA	NA	27.30	[ICRA]A- (Stable)/ [ICRA]A2+
NA	LT/ST - Unallocated	NA	NA	NA	12.81	[ICRA]A- (Stable)/ [ICRA]A2+

Source: AIL

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA	NA	NA

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