January 31, 2024

Sri Dhanalakshmi Cotton & Rice Mills Pvt. Ltd.: Ratings reaffirmed; outlook revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based/ CC	53.50	43.50	[ICRA]A(Negative); reaffirmed and outlook revised to Negative from Stable
Short-term – Fund-based	15.00	15.00	[ICRA]A1; reaffirmed
Short-term – Non-fund Based	8.00	8.00	[ICRA]A1; reaffirmed
Long-term – Unallocated	45.34	55.34	[ICRA]A(Negative); reaffirmed and outlook revised to Negative from Stable
Total	**121.84**	**121.84**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in outlook on the long-term rating to Negative from Stable considers the expected pressure on Sri Dhanalakshmi Cotton & Rice Mills Pvt. Ltd.'s (SDC) earnings and cash flows in FY2024. In FY2023, SDC's performance was subdued with 33% contraction in revenues and marginal net losses owing to sub-optimal performance of its spinning, oil, and fabric divisions. High cotton lint and cotton seed prices which could not be passed on to customers and lower volumes due to production cuts owing to unfavourable contribution margins impacted the company's scale and earnings. While ICRA expects the company's revenues to rebound by 35-45% in FY2024, operating margin is expected to remain low at ~2-2.5%, despite improvement over FY2023. While moderation in cotton prices in H2 FY2024 and improved demand for fabric are positives, subdued performance of the oil division owing to lower realisations is expected to affect its earnings and cash flows in the near term. The company has clocked revenues of Rs. 406.9 crore with operating margin of 1.9% in 9M FY2024. Nevertheless, the company remains debt free and had strong cash and liquid investments of ~Rs. 50.0 crore as of January 2024.

The ratings are supported by extensive experience of the company in the cotton industry. Besides, operational efficiency arises from the vertically integrated nature of SDC's operations, with its presence in spinning, weaving, and oil extraction and refining, along with captive hydel power and wind generation. SDC has an established market presence in the cotton seed oil industry and is one of the largest cotton seed oil extractors in India. ICRA also notes the locational advantage of SDC's plant in Guntur district of Andhra Pradesh, a prominent cotton-growing belt, resulting in easy access to raw materials. Moreover, the company's financial profile continues to be comfortable with minimal debt levels.

The ratings, however, remain constrained by the susceptibility of the company's revenues and margins to the availability and prices of cotton, which is an agro commodity. The company operates in a highly fragmented industry with commoditised nature of products restricting pricing flexibility and bargaining power to an extent. Further, the ratings factor in the high working capital intensity of SDCs operations due to cotton's seasonal availability, which requires stocking during the harvest season. This renders the company's profitability vulnerable to any volatility in cotton prices.

Key rating drivers and their description

Credit strengths

Extensive experience in cotton industry and location of plant in cotton-growing region - The company has an established presence in the textiles and cotton seed oil industries. It is one of the largest cotton seed oil extractors in India with a 600-MTPD seed processing capacity, 280-MTPD solvent extraction capacity and 50-MTPD refining capacity. Moreover, SDC enjoys established relationships with its suppliers and customers, resulting in repeat orders. SDC's spinning division (cotton yarn) has an installed capacity of 67,536 spindles; its fabric division has 120 looms; the hydel power division has a 6.2-MW power generation capacity, its windmill has a capacity of 15.3 MW and its solar power plant has a capacity of 3.02 MW. It also enjoys location-specific advantages, as its plant is located near the major cotton growing belt of Guntur, Andhra Pradesh, resulting in easy access to raw materials.

Integrated nature of operations – The company's revenue profile is diversified with vertically-integrated operations comprising spinning, weaving, oil extraction and refining, along with captive hydel power and wind energy generation, resulting in operational efficiency.

Healthy capital structure and coverage indicators - The company's capital structure remained healthy with minimal debt levels. While the coverage indicators were impacted by operating losses in FY2023, they are expected to improve going forward and are likely to remain comfortable despite lower operating margins of 2–2.5% in FY2024. The overall financial profile will remain comfortable in the absence of any major debt-funded capex and limited external borrowing.

Credit challenges

Susceptibility of profitability to volatile cotton prices and captive power generation capacity - Raw material costs are the company's major costs, accounting for close to 70-75% of its revenues over the past four years. Like other entities in the cotton industry, SDC stocks cotton during the harvest season to meet a significant portion of its off-season requirements. This stocking exposes the company to fluctuations in cotton and yarn prices during the non-harvest period, as the procurement cost is fixed, while the realisation fluctuates with cotton prices, which are driven by domestic and global factors. Firm cotton prices and pressure on realisations had constrained its contribution levels in the past. Nevertheless, the energy generated through SDC's captive power plant at a cheap rate positively impacts the cost structure.

Exposed to regulatory and agroclimatic risks - The company's revenues and margins are exposed to agroclimatic risks as availability and pricing of cotton are seasonal, with the cotton season typically running from mid-September to March. SDC is also exposed to regulatory risks with respect to the minimum support price (MSP) for raw cotton, which is decided by the Government every year.

High customer concentration risk in weaving division - The customer concentration risk is high in the fabric division with the top-five customers accounting for 85-90% of the division's sales in the past.

Commoditised nature of products and fragmented industry structure restrict pricing power and profitability - The spinning and knitting industries are highly fragmented with a significant share of the market occupied by unorganised players. While SDC 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 yarns and fabrics. As a result, it enjoys limited pricing power, which is likely to keep its profitability under check.

Liquidity position: Strong

The liquidity position is strong, with unutilised working capital limits of ~Rs. 40.0-50.0 crore and free cash and bank balances of Rs. 5.0 crore along with liquid investments of ~Rs. 44.0 crore as on January 20, 2024. Moreover, the company does not have any major capex plans in the near term or any repayment obligations.

Rating sensitivities

Positive factors – Rating upgrade is unlikely in the near term owing to Negative outlook on the ratings. However, outlook could be revised to Stable if the company demonstrates healthy growth in revenues, operating profitability and accruals, while maintaining a strong liquidity position.

Negative factors – Pressure on SDC's ratings could arise in the absence of material recovery in its earnings, or if its receivables increase, or if inventory holding impacts its liquidity position. Any major debt-funded capex adversely impacting the liquidity profile and debt protection metrics could also exert pressure on the ratings. A specific credit metric that could lead to a downgrade is if Total Debt/OPBDITA is higher than 2.0 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology - Textiles - Spinning Rating Methodology - Textiles - Fabric Rating Methodology - Edible Oil Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the company's standalone financial profile.

About the company

SDC, located in Guntur, Andhra Pradesh, was set up in 1977. It is managed by Mr. N. Raghava Rao, Mr. P. Raghava Reddy, Mr. P.V. Narayana, Mr. S. Hanumantha Rao and Mr. M. Lingaiah. The company, a closely held business, operates across oil extraction, cotton spinning, weaving, hydel power and wind power sectors, all located in Guntur and nearby regions, a major cotton-producing belt. It also owns a 9-MW windmill in Tamil Nadu. SDC's spinning division (cotton yarn) has an installed capacity of 67,536 spindles, the cotton seed oil division enjoys 600 MTPD of seed processing capacity, followed by the solvent extraction division (280 MTPD capacity) and the refining division (50 MTPD), while the fabric division has 120 looms, the hydel power division generates 6.2 MW, and the wind mill 15.3 MW of captive energy.

Key financial indicators (audited)

	FY2022	FY2023
Operating income	548.9	367.6
PAT	33.2	-5.3
OPBDIT/OI	10.3%	-0.5%
PAT/OI	6.1%	-1.4%
Total outside liabilities/Tangible net worth (times)	0.2	0.2
Total debt/OPBDIT (times)	0.1	-2.0
Interest coverage (times)	123.2	-12.8

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amounts in Rs. Crore;

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
				Jan 31, 2024	Oct 31, 2022	July 26, 2021	April 3, 2020
1 **Cash Credit**	Long-term	43.50	-	**[ICRA]A (Negative)**	**[ICRA]A(Stable)**	**[ICRA]A(Stable)**	**[ICRA]A-(Stable)**
2 **Fund-based**	Short-term	15.00	-	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A1**	-
3 **Non-fund based**	Short-term	8.00	-	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A2+**
4 **Unallocated**	Long-term	55.34	-	**[ICRA]A (Negative)**	**[ICRA]A(Stable)**	**[ICRA]A(Stable)**	**[ICRA]A-(Stable)**
5 **Term loans**	Long-term	-	-	-	-	-	**[ICRA]A-(Stable)**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based/ CC	Simple
Short-term – Fund-based	Simple
Short-term – Non-fund Based	Very Simple
Long-term – 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	**Cash Credit**	NA	NA	NA	43.50	[ICRA]A(Negative)
NA	**Working capital demand loan**	NA	NA	NA	10.00	[ICRA]A1
NA	**Short Term Loan**	NA	NA	NA	5.00	[ICRA]A1
NA	**Letter of Credit**	NA	NA	NA	7.30	[ICRA]A1
NA	**Bank Guarantee**	NA	NA	NA	0.50	[ICRA]A1
NA	**CEL**	NA	NA	NA	0.20	[ICRA]A1
NA	**Unallocated**	NA	NA	NA	55.34	[ICRA]A(Negative)

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

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Srikumar K
+91 44 45964318
ksrikumar@icraindia.com

Nithya Debbadi
+91 40 6939 6416
nithya.debbadi@icraindia.com

Raviteja Etikala
+91 40 6939 6418
etikala.teja@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@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

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ICRA Limited

Registered Office

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

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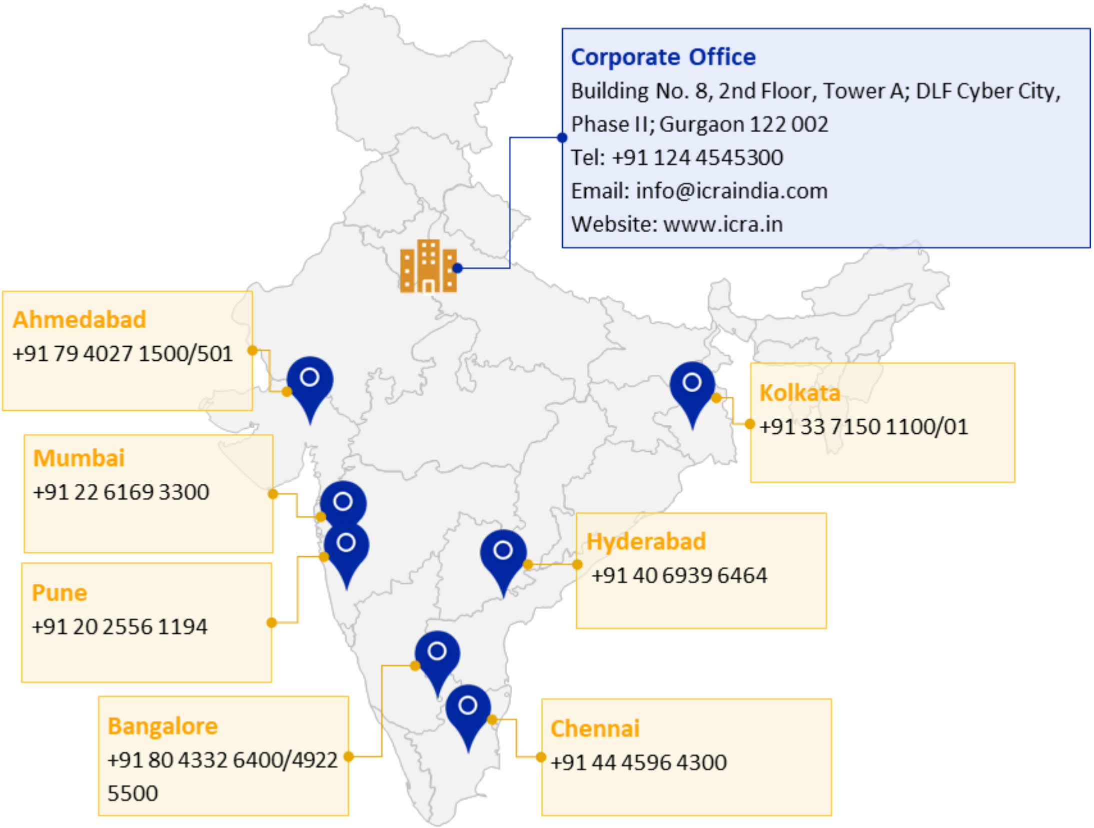

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