July 29, 2024

Aarti International Limited: 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
LT fund-based cash credit	278.40	278.40	[ICRA]A-(Negative); reaffirmed; outlook revised to Negative from Stable
LT fund-based term loan	201.49	199.27	[ICRA]A-(Negative); reaffirmed; outlook revised to Negative from Stable
LT/ST non-fund based limits	27.30	27.30	[ICRA]A-(Negative)/ [ICRA]A2+; reaffirmed; outlook revised to Negative from Stable
ST fund-based bill discounting	10.00	10.00	[ICRA]A2+; reaffirmed
LT/ST unallocated limits	2.81	5.03	[ICRA]A-(Negative)/ [ICRA]A2+ reaffirmed; outlook revised to Negative from Stable
Total	**520.00**	**520.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating action considers the weaker-than-expected performance of Aarti International Limited (AIL) in FY2024[1] due to weak demand and expectation of slower-than-expected recovery in FY2025. The company's revenue declined by ~6% in FY2024 on the back of lower realisation even as volumes rose by ~15%. While contribution levels remained flat in FY2024, the operating margins dipped to 4.5% in FY2024 from 7.2% in FY2023 with increase in power, labour and other costs, resulting in net losses. The net losses were Rs. 17.2 crore against a profit of Rs. 17.8 crore in FY2023 which led to deterioration in the entity's coverage indicators. The interest coverage and debt service coverage ratio declined to 1.9 times and 1.2 times in FY2024, respectively, from 3.4 times and 1.4 times in FY2023, respectively. While its margins are expected to improve going forward with recovery in demand conditions, the extent of improvement remains to be seen against competitive pressure. While an increase in realisation is expected, sustained expansion in operating margins, leading to an improvement in debt protection metrics remains a key monitorable.

The ratings remain supported by AIL's track record of three decades 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, partial forward integration into knitting and fabric processing and healthy capacity utilisation levels. Further, 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. Capital expenditure incurred in FY2023 and FY2024 led to an increase in AIL's spinning capacity by 18% to 42,500 tonnes per annum (TPA) and knitting capacity by 12% to 10,107 TPA in FY2024; benefits from the same are expected over the medium to long term. AIL's revenues increased at a CAGR of 8% in last five years (FY2020-FY2024) and is likely to be sustained over the medium term with gradual recovery in demand.

The ratings continue to be 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.

[1] *provisional*

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 dyeing increases the value addition and diversification, while moderating the impact of the cyclicality 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 ~96% in the company's spinning division in FY2024. ICRA notes that the capacity utilisation of AIL's fabric division improved on a YoY basis and stood at ~73% in FY2024 against 69% in FY2023. 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 improve further in the near to medium term.

Credit challenges

Deterioration in earnings and return indicators in FY2024 – AIL's performance in FY2024 was constrained because of unfavourable demand conditions leading to lower realisation and volatility in cotton prices. AIL's revenues declined by ~6% in FY2024, driven by decline in realisations. While contribution levels remained flat in FY2024, the operating margin contracted to 4.5% in FY2024 from 7.2% in FY2023 due to increase in power costs, labour and other manufacturing costs for the company. This resulted in the moderation of the company's debt protection metrics. The interest coverage and DSCR declined to 1.9 times and 1.2 times as on March 31, 2024, respectively, from 3.4 times and 1.4 times as on March 31, 2023, respectively. ICRA expects the debt metrics to improve in FY2025 with improvement in profitability due to expected recovery in demand conditions.

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, like other domestic spinning companies, has remained high over the years. AIL has incurred significant debt-funded capex between FY2022 and FY2024 (~Rs. 255 crore) towards expansion, upgradation and maintenance of its facilities and solar power projects. This has led to a sharp increase in term debt outstanding on its books, which moderated the coverage metrics at FY2023-end. In FY2024, the overage metrics deteriorated further with decline in profitability. Additionally, the year-end debt and working capital intensity level, which is high due to increased 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 has no major 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 – AIL, like other entities in the spinning sector, stocks cotton during the harvest season from October to March. This practice exposes it to the fluctuations in cotton yarn prices. This results in high dependence on working capital borrowings and keeps the leverage high, particularly at the year end. Further, as it derived about 15-18% of its revenues in the last two fiscals from exports (declined from 30-35% in the past), 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, 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, limited pricing power is likely to keep its profitability under check.

Liquidity position: Adequate

AIL's liquidity position is adequate, with cash and bank balance of Rs.3.2 crore as on June 30, 2024, and adequate buffer of ~66%, with an average utilisation of ~34% on the sanctioned lines of Rs. 278.4 crore during the 12-month period ending June 2024. Against the expected cash accruals of Rs. 65-70-crore in FY2025, it has debt repayment obligations of Rs. 45.3 crore in FY2025 and Rs. 49.8 crore in FY2026. 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, leading to an improvement in its return and debt protection metrics. Further, efficient working capital management, which improves AIL"s liquidity position could be a positive 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 Textiles - Spinning Textiles - Fabric
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financials of AIL

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 1.8 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 knitting capacity of 5.8 million kg per annum and fabric dyeing capacity of about 30 MT per day (enhanced from 21 MT per day over last four years) and a rooftop solar plant with an installed capacity of 13 MW.

AIL is part of the Ludhiana-based Aarti Group that also owns Aarti Steels Limited (ASL)[2] and Aarti Steel International Limited (ASIL)[3], who manufacture sponge iron, steel billets/ingots, rounds and bars, steel wires and ferro alloy.

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[2] ASL's bank facilities are rated [ICRA]A(Stable)/[ICRA]A2+. For detailed rating rationale, please refer to ICRA's website – www.icra.in
[3] ASIL'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 (audited/ provisional)

	FY2023	FY2024*
Operating income	1,366.3	1,285.6
PAT	17.8	(17.2)
OPBDIT/OI	7.2%	4.5%
PAT/OI	1.3%	(1.3%)
Total outside liabilities/Tangible net worth (times)	0.8	1.1
Total debt/OPBDIT (times)	3.1	7.9
Interest coverage (times)	3.4	1.9

*Source: Company, ICRA Research; * Provisional numbers; 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 (FY2025)			Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				Jul 29, 2024	Jul 13, 2023	Jan 17, 2023	Jan 3, 2022
1	Fund-Based Cash Credit	Long Term	278.40	**[ICRA]A- (Negative)**	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable); Withdrawn
2	Fund-Based Term Loan	Long Term	199.27	**[ICRA]A- (Negative)**	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable); Withdrawn
3	Non-Fund Based Limits	Long Term/ Short Term	27.30	**[ICRA]A- (Negative)/ [ICRA]A2+**	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	--
4	Fund-Based Bill Discounting	Short Term	10.00	**[ICRA]A2+**	[ICRA]A2+	--	--
5	Unallocated Limits	Long Term/ Short Term	5.03	**[ICRA]A- (Negative)/ [ICRA]A2+**	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	--
6	Bank Guarantee	Long Term	--			--	[ICRA]BBB+ (Stable); Withdrawn
7	Unallocated Limit	Long Term	--			--	[ICRA]BBB+ (Stable); Withdrawn
8	Letter of Credit	Short Term	--			--	[ICRA]A2; Withdrawn
9	Interchangeable	Long Term/ Short Term	--			--	[ICRA]BBB+ (Stable)/ [ICRA]A2; Withdrawn

Complexity level of the rated instruments

Instrument	Complexity Indicator
LT Fund-Based Cash Credit	Simple
LT Fund-Based Term Loan	Simple
LT/ST Non-Fund Based Limits	Very Simple
ST Fund-Based Bill Discounting	Simple
LT/ST Unallocated Limits	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 Cash Credit	NA	NA	NA	278.40	[ICRA]A- (Negative)
NA	LT Fund-Based Term Loan	FY2015-FY2023	7-9%	FY2024-FY2030	199.27	[ICRA]A- (Negative)
NA	LT/ST Non-Fund Based Limits	NA	NA	NA	27.30	[ICRA]A-(Negative)/ [ICRA]A2+
NA	ST Fund-Based Bill Discounting	NA	NA	NA	10.00	[ICRA]A2+
NA	LT/ST Unallocated Limits	NA	NA	NA	5.03	[ICRA]A-(Negative)/ [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

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About ICRA Limited:

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