August 01, 2024

Suryalakshmi Cotton Mills Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund Based- Cash Credit	169.50	169.50	[ICRA]BBB(Stable); reaffirmed
Long term - Fund based - Term Loan	42.48	21.00	[ICRA]BBB(Stable); reaffirmed
Short term – Non fund based	54.85	54.85	[ICRA]A3+; reaffirmed
Long term / Short term - Unallocated facilities	150.92	172.40	[ICRA]BBB(Stable)/[ICRA]A3+; reaffirmed
Total	**417.75**	**417.75**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation for the bank lines of Suryalakshmi Cotton Mills Limited (SCML) considers an expected improvement in the company's operational and financial performance over the medium term on the back of its established market position in the denim and yarn segments, promoters' long industry experience, a diversified product portfolio across the segments (denim and cotton spinning) and integrated nature of its operations. Post witnessing an improvement in FY2023, SCML's revenues moderated by 8.1% in FY2024 owing to a tepid demand environment and unfavorable price realisations. While raw material prices moderated, an increase in power and labour costs and lower realisations resulted in a 30-bps contraction in operating margin to 7% in FY2024. This coupled with an increase in interest costs and a one-time write-off for ~Rs. 2.4 crore relating to bad debts impacted the net margins, however a recovery in earnings is expected aided by an anticipated recovery from H2 FY2025. The company has a lower principal part of debt repayment obligations of Rs. 5.6 crore and Rs. 7.1 crore in FY2025 and FY2026 against the expected cash profits of ~Rs. 25-27 crore.

The ratings, however, continue to remain constrained by the moderate leverage indicators and increased working capital requirements given the seasonality associated with raw material availability. The debt funded capital expansion to increase its loom capacity, coupled with an increase in working capital utilization (towards year end stocking) led to a weakening of its debt coverage indicators in FY2024. Total debt to operating profits and interest cover ratios moderated to 4.1 times and 1.8 times in FY2024 compared to 3.2 times and 2.5 times in FY2023, respectively. Nevertheless, same is expected to improve over the medium term with a modest increase in operating margins and no major capital expansions planned by the entity. Further, the ratings consider the exposure of its earnings to volatile raw material prices with intense competition, limiting the pricing flexibility of industry players. 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. ICRA will continue to monitor the performance of the company and take suitable rating actions.

The Stable outlook on the long-term rating reflects ICRA's expectation that SCML is likely to improve its revenues and operating metrics. Further, the outlook underlines ICRA's expectation that the entity's incremental capex, if any, to further increase the capacity will be funded in a manner that it is able to durably maintain its debt protection metrics commensurate with the existing ratings.

Key rating drivers and their description

Credit strengths

Established market position – SCML has an operational track record spanning over five decades in both the denim and spinning segments, with established business channels and a diversified geographical presence across the domestic and export markets. The company's diversified business and geographical presence have helped buffer the impact of any demand slowdown. Further, SCML has strengthened its product profile within the denim fabric and yarn segments, which supported its volumes. SCML derives ~60% of its revenues from sale of denim fabric and balance is received from spinning operations (both cotton and polyester viscose). While a marginal volume growth of ~5% was witnessed in FY2024 in its denim segment, volumes in its yarn segment degrew by 2% on a YoY basis. Further, a decline in realisation led to an 8.1% decline in revenues in FY2024 on a YoY basis. SCML's revenues had increased at a CAGR of 9-10% in the last five year (FY2020-2024) and is likely to be sustained over the medium term with gradual recovery in demand.

Integrated nature of operations – SCML's operations are integrated across the spinning and weaving segments, with the overall value addition supported by a specialty yarn manufacturing unit established for captive consumption at its weaving facility. This diversified product mix supports the operating performance of the company to an extent and limits the impact of slowdown in any one segment on the overall earnings, as seen over the years.

Credit challenges

Working capital intensive operations coupled with a moderate financial profile – SCML's financial profile is characterised by moderate leverage indicators due to high working capital requirements in business and modest earnings. Increase in working capital intensity to 32.2% in FY2024 from 26.2% in FY2023, due to increased year-end stocking, led to increase in working capital borrowing to Rs. 152.2 crore as on March 31,2024 (PY -Rs. 126.9 crore). Furthermore, lower earnings led to a weakening of its debt protection metrics. Total debt to operating profits and interest cover ratios moderated to 4.1 times and 1.8 times in FY2024 compared to 3.2 times and 2.5 times in FY2023, respectively. However, the same is expected to improve over the medium term with a modest increase in operating margins and no major capital expansions planned. Nevertheless, its total debt to operating profits and the ROCE are likely to remain at modest levels over the medium term.

Intense competition exposes earnings to price risk – SCML faces intense competition in the commoditised textile industry, characterised by low product differentiation and a fragmented nature, which restricts its pricing flexibility. Thus, the earnings of SCML in the denim and yarn segments are vulnerable to the fluctuations in raw material prices, owing to limited pricing flexibility. Over the years, raw material prices witnessed volatility, which have adversely impacted the company's contribution levels and the operating margins. Further, the denim industry has witnessed significant cyclicality in the past, with periods of excess market capacity and tight demand-supply situation.

Environmental and Social Risks

Environmental considerations: As SCML operates in the textiles sector and is involved in spinning, its exposure to environmental risks emanates from the climate transition risks that could affect the prices of crude oil derivatives used for manmade fibre blending. Nevertheless, the environmental risk is mitigated in view of the relatively inelastic long-term demand from the end-user industries, including apparels and footwear, which should enable SCML to pass on the associated increase in the costs to the buyers, if the competitive pressure permits. This apart, the manufacturing process involves generation of waste. If these are discharged without adequate treatment (in breach of statutorily permissible levels), it could invite fines and penalties. While the above risks have not resulted in any material implication so far, policy actions towards waste management such as the need to recycle the packaging waste could have cost implications for entities in the sector, including SCML.

Social considerations: SCML is exposed to the risk of disruptions due to inability to manage human capital in terms of their safety and the overall well-being. Further, any significant increase in wage rates may impact the cost structure and margins to an extent. Measures taken by the company towards employee welfare and healthy value addition in the business have resulted in no material impact on SCML's performance from the above risks so far.

Liquidity position: Adequate

The liquidity position of SCML is expected to remain adequate with a buffer of Rs.12 crore on the sanctioned lines of Rs.169.5 crore as on June 30, 2024. The average utilisation of its fund-based limits over the last 12 months period ending in June 2024 stood at around 77.4%. Against the expected cash accruals of ~Rs. 25-27 crore, SCML has debt repayment obligations of Rs.5.6 crore in FY2025 and Rs.7.1 crore in FY2026. The cash accruals are expected to be sufficient to meet the debt repayment obligations and the company has no major capital expenditure plans.

Rating sensitivities

Positive factors – The ratings may be upgraded with a healthy growth in revenues and an increase in profitability, which would consequently further improve the company's debt protection metrics. A specific credit metric for an upgrade would be TD/OPBDITA below 2.5 times on a sustained basis.

Negative factors – Pressure on the ratings could arise if there is any sustained pressure on the operating performance or a deterioration in the working capital cycle, which would adversely impact the company's liquidity position and coverage metrics. A specific credit metric for the ratings downgrade would be DSCR below 1.5 times on a sustained basis.

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 financial statements of the rated entity.

About the company

SCML was incorporated in 1962, with an initial capacity of 6,000 spindles for manufacturing cotton and blended yarns. SCML was listed on both the Bombay Stock Exchange and the National Stock Exchange in May 1996. Over a period of six decades, it has expanded its spinning capacity to 86,352 spindles and has diversified into denim fabric manufacturing with a capacity of 40 million meter per annum (MMPA). SCML has an installed solar power capacity of 6 MW, which is used for captive consumption.

Key financial indicators (audited)

SCML	FY2023	FY2024
Operating income	851.0	782.4
PAT	10.4	3.6
OPBDIT/OI	7.3%	7.0%
PAT/OI	1.2%	0.5%
Total outside liabilities/Tangible net worth (times)	1.5	1.7
Total debt/OPBDIT (times)	3.2	4.1
Interest coverage (times)	2.5	1.8

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount 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	
				Aug 01, 2024	Jul 07, 2023	Apr 03, 2023	Jun 24, 2022	Dec 06, 2021	Jul 01, 2021
1	Cash credit	Long Term	169.50	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)
2	Term loan	Long Term	21.00	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)
3	Non-fund-based limits	Short term	54.85	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	[ICRA]A3	[ICRA]A4+
4	Unallocated	Long Term/ Short Term	172.40	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BB+ (Stable)/ [ICRA]A4+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Fund based-Term loan	Simple
Long-term – Fund based – Cash credit	Simple
Short Term - Non-fund based	Very Simple
Long term /Short 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	Term loan	FY2021-FY2024	-	FY2025-FY2030	21.00	[ICRA]BBB (Stable)
NA	Cash credit	-	-	-	169.50	[ICRA]BBB(Stable)
NA	Non-fund based facility	-	-	-	54.85	[ICRA]A3+
NA	Unallocated	-	-	-	172.40	[ICRA]BBB(Stable)/[ICRA]A3+

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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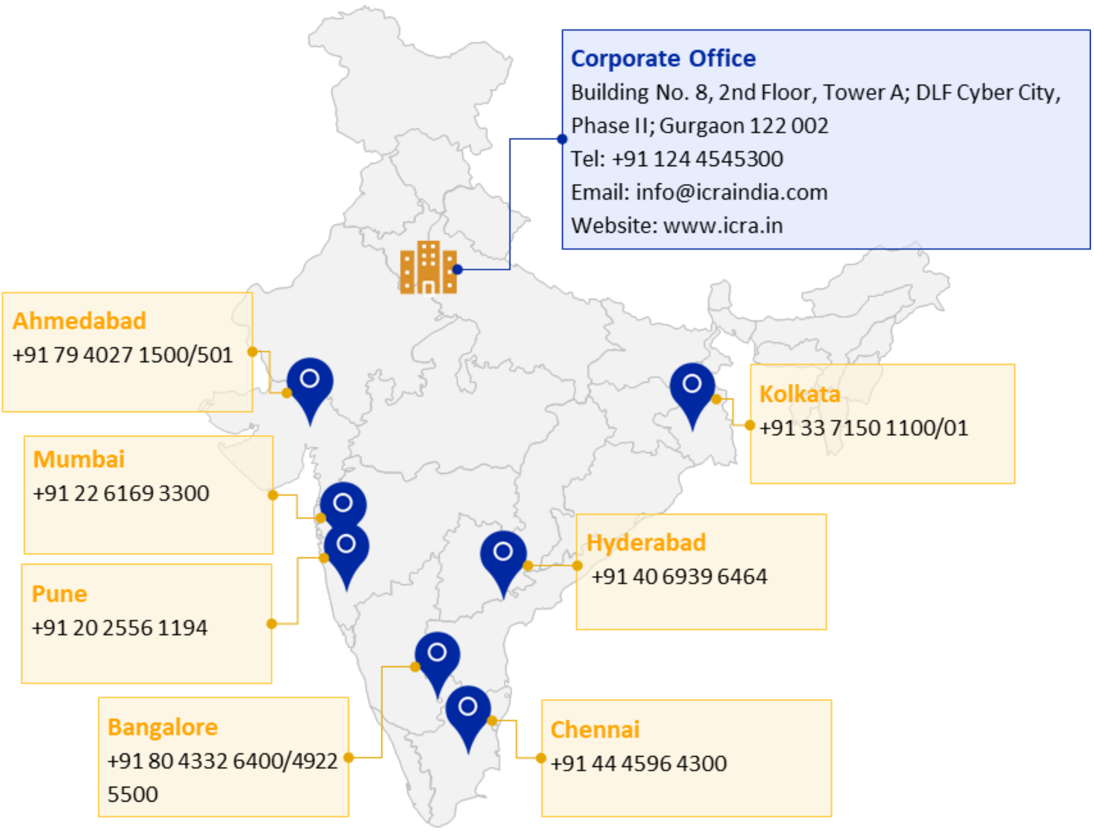

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