

June 05, 2019

Adisankara Spinning Mills Private Limited: Rating watch revised; rated amount enhanced

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based- Term Loans	20.00	23.00	[ICRA]A+@; rating placed on watch with negative implications (revised from watch with developing implications)
Fund based- Working Capital Facilities	75.00	85.00	[ICRA]A+@; rating placed on watch with negative implications (revised from watch with developing implications)
Non-fund based-Working Capital Facilities	20.00	20.00	[ICRA]A1@; rating placed on watch with negative implications (revised from watch with developing implications)
Unallocated limits	0.00	2.00	[ICRA]A+@[ICRA]A1@; ratings placed on watch with negative implications
Total	115.00	130.00	

@ Ratings under watch with negative implications

Rationale

ICRA has taken a consolidated approach in rating the eight companies of the SSM group, which 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 ratings assigned to the SSM Group of Companies have been placed on watch with negative implications (was under watch with developing implications earlier) because of the limited financial linkages between the companies in the recent past. Besides, there are uncertainties over the existing operational linkages upon completion of the ongoing business restructuring exercise within the Group. The Group at present continues to enjoy strong operational linkages, with a centralised purchase and order sourcing arrangement to leverage on the brand strength of the flagship companies and has better bargaining power with suppliers and other synergy benefits. Any change in the existing *modus operandi* because of the proposed restructuring remains to be seen. ICRA will continue to monitor developments in this regard and evaluate the impact of the restructuring on the companies' business performance once the final structure evolves. ICRA understands that this exercise, which was earlier expected to be completed by December 2017, is now likely to be completed by the end of FY2020. There has been a delay in filing of the draft scheme of arrangement with the National Company Law Tribunal (NCLT), which is expected to be done by October 2019. This exercise is being undertaken by the promoter directors to hand over the ownership and management control of the eight companies to the next generation. As a part of the arrangement, the existing assets and liabilities of the eight companies are proposed to be reallocated across the companies in varying proportions.

The re-affirmation of the ratings considers the continued steady operational and financial performance of the Group during the recent quarters, characterised by a stable volume and revenue growth and improved earnings from operations. The ratings also remain supported by the established market presence of the SSM Group, its strong operational profile and a comfortable financial profile. The operational performance during the recent quarters were supported by the improvement in export demand and its strong customer base, which coupled with the firm yarn prices had driven healthy revenue growth in FY2019. The Group's contribution levels and operating margins had also been

positively impacted by the higher-than-proportionate increase in yarn prices compared to the rise in cotton prices, with the margins expanding by around 125 bps during the last fiscal. The SSM Group's long relationship with reputed clientele across domestic and export markets is likely to support revenue growth of around 8-10% over the medium term. However, the margins could witness some pressure given the continued firm cotton prices and a steady increase in other operating costs. ICRA expects the Group's operating margins to moderate by around 100 bps in the coming quarters. Nevertheless, its overall performance would continue to be supported by its integrated presence across the value chain and favourable economies of scale, enabled by its position as one of the largest cotton spinners in South India. A considerable portion (more than 80%) of its power requirements is met with its captive windmills, lending considerable cost savings.

The financial profile of the Group remains healthy, marked by a comfortable gearing, adequate coverage indicators and a stable liquidity position. Despite the ongoing / proposed capital expenditure of Rs. 350 crore combined during FY2020 and FY2021, the overall credit metrics are expected to remain comfortable, supported by strong earnings from operations. The Total Debt to Operating profits and interest coverage ratios are likely to remain at adequate levels of 2.5 times and 6 times, respectively for FY2020. The ratings continue to factor in the relatively low operating profitability owing to the Group's limited value addition (with high dependence on low value added coarser and medium counts) and the inherently competitive nature of the industry, restricting pricing power. The SSM Group has also extended financial support (in the form of loans and advances) to some of the other companies owned by the promoter family, which stood at Rs. 60 crore as on March 31, 2019 (increased from Rs. 30 crore in the preceding fiscal). ICRA expects the Group's support to these entities to be restricted at the current levels, going forward.

Outlook: Not applicable

Key rating drivers

Credit strengths

Established presence in the medium and coarser count hosiery yarn market – The SSM Group is among the largest textile groups in South India, with an installed capacity of more than 4.8 lakh spindles along with sizeable capacities in the coarser count and fabric segments. The Group is the leading supplier of medium and coarser count hosiery yarn market in Tamil Nadu (which includes the large hosiery hub in Tirupur), apart from enjoying an established presence across other key domestic and export markets. The promoter directors, Mr. P S Veluswamy and his brother Mr. C Kandaswamy are actively involved in the day-to-day operations and possess vast experience in the textile industry, which supported the Group in building a strong client base and a leading market position in the key southern textile markets over the years.

Strong operational profile lends stability to revenues and earnings – The SSM Group enjoys an integrated presence across ring spun and open-ended yarn, knitted fabric and woven fabric segments, lending business diversification, improved economies of scale and better value addition. The Group's revenues are also diversified across domestic and export markets, buffering the impact of slowdown in any one segment. The Group also enjoys captive wind capacity of 175 MW, which caters to more than 80% of its power requirements. This apart from supporting capacity utilization on the back of recently installed direct feeder lines, also lends costs savings with the spinning sector being power intensive. These strengths, supported by its customer base and strong focus on quality, helped the Group sustain volumes and earnings in FY2017 and FY2018, when the spinning industry was facing modest demand conditions.

Comfortable financial profile – Driven by stable accruals generated over the years (utilised primarily towards reducing dependence on external debt levels) and conservative management approach towards expansion, the capitalisation ratios of the Group remained at comfortable levels over the years. Gearing and Total Debt / Operating profit were at 0.5 times and 2.5 times, respectively in FY2019, with relatively higher year-end debt levels owing to cotton procurement and

holding. Further, the Group enjoys an adequate unutilised lines of credit of more than Rs. 150 crore (with an average utilisation of 65%), lending financial flexibility. Despite the ongoing expenditure towards expansion and regular modernisation, credit metrics and liquidity position are likely to remain at comfortable levels over the medium term.

Credit challenges

Operating margins restricted by relatively low value addition in the business – SSM Group’s operating margins have been constrained over the years owing to limited value addition, with concentration on the coarser and medium counts. While the revenue contribution from the fabric segment has increased during the recent fiscals, earnings from the woven fabric and home textile segments have been limited because of the relatively low thread count and intense competition, adversely impacting fabric realisations. The operating margins have improved to some extent in FY2019, driven by healthy yarn prices, and were also supported by operational efficiency and captive power generation.

Intense competition in a highly fragmented market exposes earnings to price risk – The SSM Group operates in a highly competitive commoditised spinning industry, characterised by minimal product differentiation and fragmented nature, which restrict pricing flexibility. In addition, the requirement of stocking cotton during the harvest season results in working-capital intensive operations and exposes profitability to fluctuation in cotton prices, as witnessed over the years. Firm cotton prices and pressure on yarn realisations had constrained contribution levels in the past (as seen in FY2018), with spinners unable to sustain operating profitability amid challenging demand conditions.

Any potential impact of the restructuring exercise a key monitorable: The overall operational and financial performance of the Group over the years have been supported by strong operational and financial linkages among the Group companies, lending scale and synergy benefits and considerable financial flexibility in the form of inter-corporate loans. The funding flexibility between the companies have been limited in the recent past. Post the restructuring, any change in the current operational arrangements leading to the eight individual companies operating independently, may reduce synergy benefits and adversely impact the performance. ICRA will continue to monitor developments in this regard and evaluate the impact of the restructuring on the performance of the companies once the final structure evolves.

Liquidity position

SSM Group’s liquidity position remains comfortable, supported by its healthy earnings from operations and adequate unutilised lines of credit despite a steady increase in working capital requirements witnessed during the recent quarters. The average utilisation of its fund-based limits increased to 65% in FY2019 (compared to around 60% in FY2018) to support the Group’s rising funding requirements. Peak utilisation levels were at around 70% during the cotton procurement season and are likely to reduce in the coming quarters upon liquidation of cotton inventory. Despite the proposed cumulative capital expenditure of around Rs. 350 crore in FY2020 and FY2021, the expected steady growth in earnings (cash accruals of more than Rs. 240 crore per annum anticipated over the medium term), low repayment obligations and comfortable buffer available in utilisation of working capital limits (which is in the process of being enhanced) are likely to support the liquidity position of the SSM Group over the medium term.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Spinning Companies
Parent/Group Support	Not applicable
Consolidation / Standalone	Based on the consolidated financial statements of the eight companies in the SSM Group, details of which are provided in annexure II

About the company

Adisankara Spinning Mills Private Limited (ASMPL) was set up in 1996 to broaden the group's interest in the spinning business. In FY2006, ASMPL diversified into knitting fabric with the installation of 26 knitting machines. At present, ASMPL has two units which are involved in the manufacture of cotton yarn and knitted fabric respectively. The former has an installed capacity of 50,400 spindles, while the knitting division has a capacity of 384 knitting machines. The spinning division produces counts ranging from 20s to 40s with limited presence in value added products. Bulk of the yarn manufactured by the company finds its application in knitting fabric. Over years, ASMPL has invested in windmills and as on date it has an installed capacity of 19.4 MW.

SSM Group profile

Founded in 1981 by the Late Mr. S. Chennimalai Gounder, the SSM Group is one of the largest textile groups in South India with interests in cotton yarn, knitted fabric and woven fabric. While the operations of the Group were initiated with establishing Sri Shanmugavel Mills (P) Limited in 1981 with an installed capacity of 24,640 spindles, over the years, the Group has expanded its operations and diversified into manufacturing and sale of products such as combed cotton yarn, compact yarn, OE yarn, knitted fabric, and woven fabric. As of March 31, 2019, the Group has an installed capacity of 4,82,114 spindles, 10,368 rotors, 240 looms and 384 knitting machines, manufacturing products across the textile value chain. The Group also has 230 windmills with a capacity to generate 176.25 MW power.

Key financial indicators (Consolidated)

Fiscal	FY2018	FY2019
Operating Income (Rs. crore)	3096.3	3438.7
PAT (Rs. crore)	258.4	329.3
OPBDIT/ OI (%)	8.3%	9.6%
RoCE (%)	9.8%	11.8%
Total Debt/ TNW (times)	0.5	0.5
Total Debt/ OPBDITA (times)	2.6	2.4
Interest coverage (times)	6.4	6.9

Note: FY2019 figures are provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs Crore)	Date & Rating June 2019	Date & Rating in FY2018 March 2018	Date & Rating in FY2018 June 2017	Date & Rating in FY2017 Jan 2017
1 Fund based-Term Loans	Long Term	23.00	23.00	[ICRA]A+@	[ICRA]A+&	[ICRA]A+&	[ICRA]A+ (stable)
2 Fund based-Working Capital Facilities	Long Term	85.00	-	[ICRA]A+@	[ICRA]A+&	[ICRA]A+&	[ICRA]A+ (stable)
3 Non-fund based-Working Capital Facilities	Short Term	20.00	-	[ICRA]A1@	[ICRA]A1&	[ICRA]A1&	[ICRA]A1
4 Unallocated limits	Long Term/ Short Term	2.00	-	[ICRA]A+@/ [ICRA]A1@	[ICRA]A+& / [ICRA]A1&	[ICRA]A+& / [ICRA]A1&	[ICRA]A+ (stable) / [ICRA]A1

Source: ASMPL

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	Aug 2018	-	Oct 2022	23.00	[ICRA]A+@
NA	Cash credit	-	-	-	85.00	[ICRA]A+@
NA	Letter of credit	-	-	-	20.00	[ICRA]A1@
NA	Fund based (Unallocated)	-	-	-	2.00	[ICRA]A+@/ [ICRA]A1@

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Sri Shanmugavel Mills Private Limited	-	Full Consolidation
Sudhan Spinning Mills Private Limited	-	Full Consolidation
Sivaraj Spinning Mills Private Limited	-	Full Consolidation
Prabhu Spinning Mills Private Limited	-	Full Consolidation
Sri Velayudhaswamy Spinning Mills Private Limited	-	Full Consolidation
Vedha Spinning Mills Private Limited	-	Full Consolidation
Sri Matha Spinning Mills Private Limited	-	Full Consolidation

Note: The above companies are consolidated with ASMPL because of the strong operational linkages and common management
Source: ASMPL

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1120
jayanta@icraindia.com

Balaji M

+91 44 4596 4317
balaji.m@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:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2019 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents