

September 24, 2021

Vedha Spinning Mills Private Limited: Rating watch revised to developing implications from negative implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Term Loans	44.50	47.36	[ICRA]BBB- &; rating watch revised to developing implications from negative implications
Long-term Fund-based Cash Credit	65.00	85.00	[ICRA]BBB- &; rating watch revised to developing implications from negative implications
Short-term Non-fund based – Working capital facilities	10.00	10.00	[ICRA]A3 &; rating watch revised to developing implications from negative implications
Long-term/Short-term Unallocated	30.50	7.64	[ICRA]BBB- &/[ICRA]A3 &; rating watch revised to developing implications from negative implications
Total	150.00	150.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings of Vedha Spinning Mills Private Limited (VSPL) have been placed on watch with developing implications, revised from watch with negative implications, after ICRA took note of the scheme of arrangement filed by VSPL with National Company Law Tribunal (NCLT) as a part of the restructuring existing within the SSM Group¹. As a part of the restructuring exercise, the existing assets and liabilities of the SSM Group companies are being reallocated among them in varying proportions. Based on the proposed transfer of assets and liabilities as a part of the scheme, VSPL's credit profile is unlikely to be adversely impacted. While VSPL's capacity and scale of operations would witness moderate reduction upon the implementation of the proposed structure, its capital structure and debt protection metrics are expected to be supportive of the credit profile. Nevertheless, the ratings remain on watch as the ongoing business restructuring is yet to be completed, with the final approval from the NCLT being pending. While operational synergies including a centralised purchase and order sourcing arrangement continue at present, the degree of operational linkages among the companies upon completion of the restructuring exercise remains to be seen. ICRA understands that this exercise is likely to be completed by March 2022, with the filing of the draft scheme of arrangement with NCLT done in March 2021. This exercise is being undertaken by the promoter directors to hand over the ownership of the eight companies in the SSM Group to the next generation.

VSPL's operating performance in FY2021 remained stable, despite the business disruptions caused by the Covid-19 pandemic on its performance in the first quarter. VSPL's performance in FY2021 was supported by demand recovery in H2FY2021, which resulted in better volumes and healthy expansion in contribution margins. With expected steady growth in volumes and better

¹ The eight companies rated and collectively referred to as the SSM Group 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

price realisations, operating performance of VSPL is expected to remain stable in the coming quarters. However, given the recent debt funded capex incurred and high working capital requirements in the business, VSPL's credit metrics remain at moderate levels. The ratings factor in the operational synergies enjoyed for being a part of the large SSM Group, one of the largest cotton spinners in South India with an established market presence in the knitted yarn market. VSPL's credit profile remains constrained by its low operating profitability (because of the limited value addition with high dependence on low value-added medium counts) and the inherently competitive nature of the industry, which restricts its pricing power.

Key rating drivers and their description

Credit strengths

Established presence in hosiery yarn market - VSPL enjoys scale and synergy benefits from operationally being a part of a larger group, with cotton procurement and order sourcing continuing to be centralised at present. The SSM Group is among the largest textile groups in South India, with an installed capacity of around 5.5 lakh spindles and sizeable capacities in the fabric segment. The SSM Group is the leading supplier of medium and coarser count hosiery yarn market in Tamil Nadu (which includes the large hosiery hub in Tirupur) and enjoys an established presence across other key domestic and export markets.

Credit challenges

Moderate operating profitability and earnings exposed to fluctuations in raw material prices- Notwithstanding the improvement in the operating margins witnessed in recent quarters, VSPL's margins have been constrained over the years. This was mainly because of its limited product diversification with concentration on coarser and medium counts entailing relatively low value addition. Margins over the years have been supported to an extent by the captive power generation and focus on cost savings. VSPL operates in a highly competitive and commoditised spinning industry which restricts pricing flexibility and exposes the earnings to fluctuation in raw material prices.

Modest credit metrics limited by high debt levels - VSPL's credit metrics remain at modest levels, primarily constrained by the debt funded capital expenditure incurred in recent fiscals and high working capital requirements in the business. The same is despite some improvement witnessed in key debt protection indicators in FY2021, on the back of better earnings in recent quarters. However, given the expected steady growth in earnings and limited capital expenditure plans, VSPL's leverage indicators and coverage metrics are likely to improve to adequate levels over the medium term.

Liquidity position: Stretched

VSPL's liquidity position remains tight, constrained by the high working capital requirements in the business resulting in limited unutilized lines of credit. Overall liquidity position of the entity remained supported by the additional covid lines of around Rs. 18 crores availed in FY2021. Despite the same, average utilisation of its fund-based limits stood high at around 90% over the 12-month period ending July 2021. While VSPL's earnings are likely to register steady growth in the coming quarter, its free cash flows are likely to be limited by the incremental working capital requirements and cumulative cash outflow of around Rs. 15 crores towards capital expenditures envisaged and debt repayment obligations in the near term.

Rating sensitivities

Positive factors – The ratings may be upgraded upon completion of the ongoing restructuring exercise with final approval from NCLT and if there is a sustained improvement in the overall credit profile of the company commensurate with the higher rating levels.

Negative factors – ICRA may downgrade the ratings, if there is a sustained pressure on the company's operating performance or upon elongation of its working capital cycle or any significant debt-funded capex, which would adversely impact its credit metrics and liquidity position. Specific credit metrics which may result in a downward rating action include Total Debt/

OPBITDA exceeding 3.0 times and DSCR remaining below 1.4 times on a sustained basis. The ratings may also be downgraded in case of any adverse impact on the company's credit profile upon completion of the restructuring exercise.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry - Spinning
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

Incorporated in January 2002, Vedha Spinning Mills Private Limited (VSMPL) is one of the smaller companies in the SSM Group. The company operates with an installed capacity of 57,744 spindles and 100 knitting machines and is located in the vicinity of other group companies in Dindigul, Tamil Nadu. The company produces cotton yarn (ring spinning), with primary focus on the count range of 30s with limited value addition. VSMPL sells its produce mainly to the domestic customers with some exports made to Sri Lanka and Bangladesh. Over the years, VSMPL has invested steadily in windmills and has an installed capacity of 11.0 MW.

Key financial indicators (Audited)

	FY2020	FY2021 (Prov)
Operating Income (Rs. crore)	285.5	407.5
PAT (Rs. crore)	0.6	6.5
OPBDIT/OI (%)	6.2%	6.9%
RoCE (%)	4.1%	9.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.7	2.0
Total Debt/OPBDIT (times)	4.9	4.4
Interest Coverage (times)	2.8	3.3
DSCR (times)	1.9	2.3

Source: Company

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: $PBIT / \text{Avg} (\text{Total Debt} + \text{Tangible Net Worth} + \text{Deferred Tax Liability} - \text{Capital Work in Progress})$; DSCR: $(PBIT + \text{Mat Credit Entitlements} - \text{Fair Value Gains through P\&L} - \text{Non-cash Extraordinary Gain/Loss}) / (\text{Interest} + \text{Repayments made during the Year})$

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding as of September 16, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020		Date & Rating in FY2019
				Sep 24, 2021	Sep 28, 2020	May 04, 2020	Feb 07, 2020	Jun 05, 2019	-
1 Term Loan	Long term	47.36	47.36	[ICRA]BBB-&	[ICRA]BBB-@	[ICRA]A-@	[ICRA]A@	[ICRA]A+@	-
2 Working capital facility	Long term	85.00	-	[ICRA]BBB-&	[ICRA]BBB-@	[ICRA]A-@	[ICRA]A@	[ICRA]A+@	-
3 Non-fund based facility	Short term	10.00	-	[ICRA]A3&	[ICRA]A3@	[ICRA]A2+@	[ICRA]A2+@	[ICRA]A1@	-
4 Unallocated facility	Long term/ Short term	7.64	-	[ICRA]BBB-&/ [ICRA]A3&	[ICRA]BBB-@/ [ICRA]A3@	[ICRA]A-@ / [ICRA]A2+@	[ICRA]A@ / [ICRA]A2+@	[ICRA]A+@ / [ICRA]A1@	-

Source: Company

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loan	Simple
Working capital facility	Simple
Non-fund based facility	Very Simple
Unallocated facility	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: 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	FY2021	-	FY2027	47.36	[ICRA]BBB-&
NA	Cash Credit	-	-	-	85.00	[ICRA]BBB-&
NA	Non-fund based	-	-	-	10.00	[ICRA]A3&
NA	Unallocated facility	-	-	-	7.64	[ICRA]BBB-&/ [ICRA]A3&

Source: Company

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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