October 10, 2022

Nandan Denim Limited: Ratings reaffirmed; Outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based - Cash Credit	240.00	240.00	[ICRA]BBB (Stable); reaffirmed; outlook revised to Stable from Positive
Fund based - Term Loan	326.81	326.81	[ICRA]BBB (Stable); reaffirmed; outlook revised to Stable from Positive
Non-fund Based - Letter of Credit/Bank Guarantee	60.00	60.00	[ICRA]A3+; reaffirmed
Unallocated Limits	108.54	108.54	[ICRA]BBB (Stable)/[ICRA]A3+; reaffirmed; outlook on the long-term rating revised to Stable from Positive
Total	**735.35**	**735.35**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook on the long-term rating of Nandan Denim Limited (NDL) reflects ICRA's expectation of lower-than-previously estimated profitability in the current fiscal, amid all-time high cotton prices seen in the recent quarters, which has constrained its pricing flexibility. Along with sizeable scheduled repayment obligations in the current fiscal, this is likely to moderate the company's coverage metrics vis-à-vis the earlier estimates. Nevertheless, the company's liquidity position remains adequate, corroborated by ~30% cushion in the company's fund-based working capital limits, despite prepayments made towards some term loans during the current fiscal. The ratings remain constrained by the inherent cyclicality associated with the denim sector and the working capital-intensive nature of the company's operations.

The ratings, however, continue to draw strength from NDL's strong market position as one of the leading denim capacities in the domestic market, its diversified product profile and the extensive industry experience of its promoters. The ratings also take comfort from the company's proximity to the cotton-growing belt and its backward integrated operations, which support its cost structure. ICRA also notes NDL's eligibility for various Government incentives on the capex in the past, which supports its profitability, though their timely receipt is important.

The Stable outlook on [ICRA]BBB reflects ICRA's opinion that an adequate liquidity position and recovery in performance in H2 FY2023 will support the company's debt servicing capability, despite a moderation expected in coverage metrics owing to profitability pressure and sizeable repayment obligations in FY2023. ICRA expects the company to maintain its business positioning in the denim industry.

Key rating drivers and their description

Credit strengths

Established market position as one of the country's leading denim manufacturers – NDL is a part of the Ahmedabad-based Chiripal Group, which has been in the textile business since 1972 and enjoys diversified operations in the textile value chain with manufacturing partially-oriented yarn (POY), fully drawn yarn (FDY) and draw texturised yarn (DTY), along with fabric processing. NDL has an integrated manufacturing unit, comprising production facilities from spinning to fabric finishing. The company has an established market position and is one of the largest denim manufacturers in India, with a capacity of 110 million meters per annum (MMPA). NDL primarily caters to the low-medium quality denim segment, which has a larger market size than the premium denim segment. NDL has a well -established network of distributors in the domestic market and enjoys strong relationship with its clients, which can be attributed to the Chiripal Group's long presence in the textile business.

Proximity to cotton-growing belt and backward-integrated operations support operational risk profile – NDL's manufacturing facilities at Sejpur-Gopalpur in Ahmedabad are in proximity to the cotton-growing belt in Gujarat. Further, the backward-integrated operations enable the company to meet a significant share of its yarn requirement from the in-house capacities. While its presence in the spinning segment exposes the company's profitability to volatility in cotton prices, it facilitates cost savings on transportation. Further, as observed in the past, wherein surge in yarn prices has been steeper than the increase in cotton prices, captive yarn capacity reduced the impact on the company's profitability.

Eligibility for Government schemes supports overall returns; timely receipt of the same remains crucial – Various sections of capex undertaken by NDL are eligible for incentives under different Central and state Government schemes such as interest subsidy on term loan, capital subsidy on plant and machinery, Goods & Service Tax (GST) refund and power subsidy. These incentives support the company's overall returns, however, timely receipt of the same remains crucial.

Credit challenges

Moderation in performance amid increased raw material prices; profitability remains vulnerable to adverse fluctuations in key raw material prices – The profit margins of the company are largely affected by the raw material price fluctuations, as the ability to fully pass on the cost increases gets constrained due to cyclical demand conditions and intense competition in the sector. The operating margins of NDL declined to 7.9% in FY2022 and further to 4.9% in Q1 FY2023 from 9.2% in FY2021. Amid cost side pressure this year, NDL's profitability is expected to be lower than the previous estimates, resulting in weaker-than-expected debt coverage metrics.

High working capital intensity – The working capital intensity of NDL has remained high with NWC/OI at 24% in FY2022-end mainly because of elongated receivables and high inventory holding. The inventory remains high as the company stocks cotton during the year-end with expectations of price increase during the lean season. Thus, on one hand, the company's profitability remains susceptible to unforeseen corrections in cotton prices, which can lead to inventory losses; on the other hand, a stable price may lead to higher carrying cost without any foreseen benefits.

Cyclicality in the denim industry – The denim industry witnesses inherent cyclicality, with periods of excess market capacity and tight demand-supply situations. An oversupply situation exerts pressure on the company's profitability, by adversely impacting the volumes and pricing power in line with the industry trends.

Environmental and Social Risks

NDL's exposure to environmental risks are mainly related to the climate impact of post-consumer waste. While these risks have not resulted in any material implication so far, policy actions towards waste management such as recycling the textile and packaging the waste being generated could have cost implications for the companies in the segment. This apart, the dyeing and processing of fabrics cause water pollution and result in significant waste-water generation. Lack of proper systems to ensure appropriate pre-treatment of wastewater and avoid leakages etc. could result in significant penalties, while also causing prolonged disruptions to operations due to strict action by authorities. However, the company is focusing on sustainable practices, such as using eco-friendly fabrics and chemicals, waste management, wastewater treatment, reusing treated water and improving the contribution of renewable energy in the total energy mix, to mitigate the related risks.

NDL's exposure to social risks mainly emanates from the disruptions caused by its inability to properly manage human capital in terms of their safety and overall well-being. In this context, ICRA notes the two fire incidents which happened in the company's shirting plant and spinning plant (at Piplej, Ahmedabad) in February 2020 and August 2020, respectively. The first incident resulted in the death of seven workmen. Further, both incidents disrupted production and caused damages to the machinery, inventory and factory premises. Such incidents, which raise concern over the safety of employees, expose the company to significant social risks. Besides, human rights issues and inability to ensure diversity, while providing equal opportunity could pose social risks for the company. The shortage of skilled workers or protests/conflicts with local communities could also affect the operations/growth plan and remains a key concern.

Liquidity position: Adequate

NDL's liquidity profile remains adequate, with availability of free cash and cash equivalents of ~Rs.19 crore as on June 30, 2022 and an average cushion of around Rs. 73 crore (equivalent to ~30% of the sanctioned limits) in the company's fund-based working capital limits in the six-month period ended in August 2022. Overall, ICRA expects NDL to be able to meet its near-term commitments through internal as well as external sources.

Rating sensitivities

Positive factors – ICRA could upgrade NDL's ratings if a) there is a continued growth in revenues and increase in profitability, which supports an improvement in its coverage metrics; b) liquidity profile strengthens, while sustaining a comfortable capital structure.

Negative factors – ICRA could downgrade the ratings if there is pressure on the operating performance, or any stretch in working capital cycle/ sizeable debt-funded capex adversely impacts the credit metrics and the company's liquidity position. A specific trigger would include an interest cover of less than 3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology - Textiles Industry (Spinning) Rating Methodology - Textiles Industry (Fabric Making)
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financials of NDL

About the company

Nandan Denim Limited (NDL) (earlier known as Nandan Exim Limited), incorporated in 1994 by Mr. Vedprakash Chiripal and Mr. Brijmohan Chiripal, started with manufacturing, trading and export of textile products. NDL is a part of the Ahmedabad-based Chiripal Group, which has presence in various industries such as textiles, education, real estate, packaging and chemicals. In FY2004, the company forayed into the manufacturing of denim fabric and has undertaken periodical expansion in the segment since then. At present, NDL has an installed capacity of manufacturing 110 MMPA of denim fabric. NDL also underwent backward integration by installing a cotton spinning unit in FY2011 and increased its capacity to 141 tonnes per day (TPD) over the years (reduced to 104 TPD due to a fire incident in August 2020). NDL also diversified its product portfolio by setting up a 10-MMPA shirting capacity in FY2014. The company also operates a 15-MW power plant within its premises, which meets its entire power requirements. NDL has two manufacturing facilities at Sejpur-Gopalpur in Ahmedabad (Gujarat).

Key financial indicators (audited)

	FY2021	FY2022
Operating Income (Rs. crore)	1,111	2,188
PAT (Rs. crore)	-18.7	67.8
OPBDIT/OI (%)	9.2%	7.9%
PAT/OI (%)	-1.7%	3.1%

Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.7
Total Debt/OPBDIT (times)	5.4	3.2
Interest Coverage (times)	2.4	4.1

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Source: NDL

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2022 (Rs. crore)	Date & Rating in FY2023		Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020		
					Oct 10, 2022	Aug 3, 2022	Jan 24, 2022	Mar 22, 2021	Dec 04, 2020 Aug 17, 2020	Feb 13, 2020	Feb 04, 2020	Jun 4, 2019
1	Term Loan	Long-term	326.81	311.11	[ICRA]BBB (Stable)	[ICRA]BBB (Positive)	[ICRA]BBB (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB+ @	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
2	Cash Credit	Long-term	240.0	-	[ICRA]BBB (Stable)	[ICRA]BBB (Positive)	[ICRA]BBB (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB+ @	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
3	EPC/FBD	Short term	-	-	-	-	-	-	[ICRA]A3	[ICRA]A2@	[ICRA]A2	[ICRA]A2+
4	Letter of Credit / Bank Guarantee	Short term	60.0	-	[ICRA] A3+	[ICRA] A3+	[ICRA] A3+	[ICRA]A3	[ICRA]A3	[ICRA]A2@	[ICRA]A2	[ICRA]A2+
5	Unallocated Limits	Long-term/ Short term	108.54		[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Positive)/ [ICRA]A3+	[ICRA]BBB (Positive)/ [ICRA]A3+	[ICRA]BBB- (Stable)/ [ICRA] A3	-	-	-	-

@: Under rating watch with negative implications

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund based - Cash Credit	Simple
Fund based - Term Loan	Simple
Non-fund Based - Letter of Credit/Bank Guarantee	Simple
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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based - Cash Credit	NA	NA	NA	240.00	[ICRA]BBB (Stable)
NA	Fund based - Term Loan	FY2015	NA	FY2027	326.81	[ICRA]BBB (Stable)
NA	Non-fund Based - Letter of Credit/Bank Guarantee	NA	NA	NA	60.00	[ICRA]A3+
NA	Unallocated Limits	NA	NA	NA	108.54	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: *NDL*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA	NA	NA

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About ICRA Limited:

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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.

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