

August 16, 2023

Nandan Denim Limited: Ratings downgraded to [ICRA]BB+(Negative)/[ICRA]A4+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-Term - Fund-based- Cash Credit	240.00	240.00	[ICRA]BB+ (Negative); downgraded from [ICRA]BBB- (Negative)
Long-Term - Fund -based- Term Loan	251.56	251.56	[ICRA]BB+ (Negative); downgraded from [ICRA]BBB- (Negative)
Short-Term - Non-fund-based facilities- Letter of Credit/Bank Guarantee	60.00	60.00	[ICRA]A4+; downgraded from [ICRA]A3
Total	551.56	551.56	

*Instrument details are provided in Annexure-I

Material Event

Nandan Denim Limited (NDL) announced its Q1 FY2024 results and annual report for FY2023 to the stock exchange on August 4, 2023. In Q1 FY2024, NDL reported an operating income of Rs. 554.4 crore (a YoY decline of 41.4%) with an operating profit margin (OPM) of 4.2%, against 4.9% in Q1 FY2023 (5.1% in Q4 FY2024). In FY2023, the company reported an operating income of Rs. 2,026.8 crore (YoY decline of 7.4%) with an OPM of 4.2% against 7.9% in FY2022. The annual report had an observation from the auditor on delays in servicing packing credit obligations availed from a bank for 21 days. ICRA has noted that the delay was due to a technical reason, which was confirmed by the banker and the management team.

Impact of Material Event

ICRA has downgraded the long-term rating to [ICRA]BB+ (pronounced ICRA double B plus) from [ICRA]BBB- (pronounced ICRA triple B minus) and has also downgraded the short-term rating to [ICRA]A4+ (pronounced ICRA A four plus) from [ICRA]A3 (pronounced ICRA A three) for the Rs. 551.56-crore bank lines of the company. The outlook on the long-term rating continues to be Negative.

Rationale

The ratings have been downgraded due to an overall weakening in the financial performance and operating profitability of the company in Q1 FY2024. NDL's operating income witnessed a higher-than-anticipated fall of ~41% to Rs. 554.4 crore and its EBITDA margins reduced by 70 bps to 4.2% in Q1 FY2024 on a YoY basis. Besides, its Net Cash Accruals (NCA) had reduced to Rs.11.4 crore in Q1 FY2024 from Rs.25.1 crore in Q1 FY2023, leading to lower cash generated from business operations. The interest coverage and liquidity position of the company have also weakened with the interest coverage in Q1 FY2024 deteriorating to 2.0x from 3.2x in Q1 FY2023. Further, the company's liquidity profile is stretched due to continuing lower profitability both in FY2023 and Q1 FY2024. Given the weak net cash accruals in Q1 FY2024 and weak operating environment for players in the denim segment, the coverage metrics of the company are likely to be affected. Timely receipt of insurance claims towards supporting the interim cash flows would be a key monitorable. ICRA notes the prepayment of debt worth Rs. 10 crore in Q1 FY2024 and Rs. 2.25 crore in July 2024.

The ratings 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 to a certain extent.

The outlook on the long-term rating continues to be Negative owing to a weak operating environment and a stretch in the liquidity profile.

ICRA also notes that there has been a delay in the payment of debt obligations (export packing credit, delay in payment of 21 days) by the company vis-a-vis the due date of payment. The entity had sufficient funds available in its cash credit account for servicing the packing credit installments before the due dates, as confirmed by the banker and the company. ICRA has not treated this instance as default, as the delay was due to technical reasons and the same had been regularised within 30 days. This treatment is in line with ICRA's Policy on Default Recognition ([Click here](#)).

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 metres 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.

Credit challenges

Sharp dip in performance amid increased raw material prices and reduction in subsidies – The profit margins of the company are mainly affected by the raw material price fluctuations as the ability to fully pass on the cost price increase gets constrained due to cyclical demand conditions and intense competition in the sector. The operating margins of NDL had declined to 4.2% in FY2023 from 7.9% in FY2022 and continued to remain low even in Q1 FY2024 at 4.2%. Cotton raw material stocks accumulated in Q2 FY2023 at lifetime high prices were used in Q3 FY2023, post a decline in cotton prices. This coupled with lower price realisations on yarn impacted profits in FY2023. In Q3 FY2023, the entity incurred a net loss of 5.1%. The same improved to a breakeven in Q4 FY2023. Also, various sections of capex undertaken by NDL were eligible for incentives under different Central and State Government schemes. The entity has ceased to receive interest subsidy from FY2023, leading to an increase in the borrowing cost. Going forward, other subsidies will also reduce due to the completion of the subsidy receipt period. A decline in profitability in FY2023 also impacted the coverage indicators. The interest coverage ratio fell to 1.6x in FY2023 from 4.1x in FY2022. ICRA expects the coverage indicators to remain stretched in the near-to-medium term with reduction in subsidy received and expected muted growth in profitability in FY2024 on the back of a weak operating environment.

High working capital intensity – Though the working capital intensity eased to 23.4% in FY2023 from 24.4% in FY2022, the same for NDL has remained high 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 costs without any foreseen benefits.

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

Liquidity position: Stretched

NDL’s liquidity profile is stretched due to lower profitability in FY2023 and Q1 FY2024. NDL had free cash and cash equivalents of ~Rs.3.2 crore as on March 31, 2023, and a cushion of ~Rs. 3 crore (equivalent to ~1.25% of the sanctioned limits) in the company’s fund-based working capital limits as of end March 2023. The company has ~Rs.63-crore debt repayment obligations (of which the company has prepaid Rs. 10.0 crore in Q1 FY2024 and Rs. 2.25 crore in July 2023, through the insurance claim of Rs. 13.6 crore received in Q1 FY2024) in FY2024 against a projected NCA of Rs. 38.4 crore in FY2024. In addition, the management has indicated that an insurance claim of ~Rs. 40 crore is likely to be received in H1 FY2024 along with a TUF subsidy (expected to be received in H2 FY2024). These would be utilised to prepay the term debt obligations. Overall, ICRA expects NDL to be able to meet its near-term commitments through internal as well as external sources.

Rating sensitivities

Positive factors – A near-term upgrade in ratings is unlikely. The outlook can be revised to Stable if there is a marked increase in NDL’s revenues and profitability, and an improvement in its coverage metrics. Strengthening of the liquidity profile while building up capital buffers would remain crucial for a revision in the outlook.

Negative factors – ICRA could downgrade the ratings if there is pressure on the operating profitability, or any stretch in the working capital cycle or any sizeable debt-funded capex, which adversely impacts the credit metrics and the company’s liquidity position. A specific trigger for ratings downgrade includes an interest cover of less than 2.4 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

Incorporated in August 1994 as a private limited company by Mr. Vedprakash Chiripal and Mr. Brijmohan Chiripal, Nandan Denim Limited (NDL, earlier known as Nandan Exim Limited) started with trading and exporting of textile products and was converted into a public limited company in January 2004. In FY2004, the company forayed into manufacturing operations with weaving of denim fabric with a capacity of 20 million meters per annum (MMPA) and increased the capacity to 110 MMPA over the years. NDL installed a cotton spinning unit having a capacity of 40 TPD in FY2011 and increased the capacity to 142 TPD over the years (reduced to 104 TPD due to a fire incident in August 2020) to backward integrate. Further, to mitigate the product concentration risk, NDL installed a 10-MMPA shirting capacity in FY2014. The company has two manufacturing facilities located at Sejpur-Gopalpur in Ahmedabad (Gujarat). The company also operates a 15-MW solar power plant within

its premises, which meets its entire power requirements.

Key financial indicators

	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	Q1FY2024 (Unaudited)
Operating Income (Rs. crore)	1,110.5	2,188.4	2,026.8	557.3
PAT (Rs. crore)	-18.7	67.8	0.8	1.7
OPBDIT/OI (%)	9.2%	7.9%	4.2%	4.2%
PAT/OI (%)	-1.7%	3.1%	0.0%	0.3%
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.7	1.3	NA
Total Debt/OPBDIT (times)	5.4	3.2	5.5	NA
Interest Coverage (times)	2.4	4.1	1.6	2.0

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 (FY2024)				Chronology of Rating History for the past 3 years								
	Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2023 (Rs. crore)	Date & Rating on			FY2023				Date & Rating in FY2022		Date & Rating in FY2021
				Aug 16, 2023	Jun 28, 2023	Jun 14, 2023	Mar 6, 2023	Nov 23, 2022	Oct 10, 2022	Aug 3, 2022	Jan 24, 2022	Mar 22, 2021	Dec 04, 2020 Aug 17, 2020
1 Term Loan	Long-term	251.56	209.00	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)
2 Cash Credit	Long-term	240.0	--	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)
3 EPC/FBD	Short term	--	--	--	--	--	--	--	--	--	--	--	[ICRA]A3
4 Letter of Credit / Bank Guarantee	Short term	60.0	--	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	[ICRA]A3	[ICRA]A3
5 Unallocated Limits	Long-term/ Short term	--	--	--	--	--	--	--	--	[ICRA]BB (Stable)/A3+	[ICRA]BBB- (Positive)/A3+	[ICRA]BBB- (Positive)/A3+	[ICRA]BBB- (Stable)/A3

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

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 analyzing 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, is available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund based - Cash Credit	NA	NA	NA	240.00	[ICRA]BB+ (Negative)
NA	Fund based - Term Loan	FY2015	NA	FY2027	251.56	[ICRA]BB+ (Negative)
NA	Non-fund Based - Letter of Credit/Bank Guarantee	NA	NA	NA	60.00	[ICRA]A4+

Source: NDL

[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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