August 23, 2024

Deepak Spinners Limited: Ratings reaffirmed; Outlook on long-term rating revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund Based – Cash Credit	60.00	60.00	[ICRA]A-; Reaffirmed and Outlook revised to Negative from Stable
Long-term - Fund Based – Term Loan	8.90	0.00	-
Short term - Fund Based – Standby Line of Credit	5.00	0.00	-
Short term - Fund Based – Export Packing Credit (Interchangeable)^	(15.00)	(15.00)	[ICRA]A2+; Reaffirmed
Short term - Fund Based – Bill Discounting (Interchangeable)^	(15.00)	(15.00)	[ICRA]A2+; Reaffirmed
Short term - Non-Fund Based – Letter of Credit	2.00	2.00	[ICRA]A2+; Reaffirmed
Short term - Non-Fund Based – Capex Letter of Credit	10.00	10.00	[ICRA]A2+; Reaffirmed
Short term - Non-Fund Based – Credit Exposure Limit	1.00	1.00	[ICRA]A2+; Reaffirmed
Long-term - Non-Fund Based – Bank Guarantee	3.00	3.00	[ICRA]A-; Reaffirmed and Outlook revised to Negative from Stable
Long-term/ Short-term - Unallocated limit	2.20	16.10	[ICRA]A- /[ICRA]A2+; Reaffirmed and Outlook revised to Negative from Stable
Total	**92.10**	**92.10**	

**Instrument details are provided in Annexure-I; ^Within the overall fund-based working capital limit*

Rationale

The revision in the outlook on the long-term rating of Deepak Spinners Limited (DSL) to Negative from Stable mainly considers the sequential weakening of its operating margin over the last five quarters with an operating loss in Q1 FY2025 due to an adverse demand-supply situation in the synthetic yarns industry, exerting pressure on DSL's financial performance. The spread between the company's realisation and raw material prices, like many other man-made fibre (MMF) players, has remained under pressure in the recent quarters on the back of a surge in import of MMF yarns/fabrics at cheap rates from China and a prolonged weakness in the key export markets, mainly the US and Europe, which in turn led to a supply glut in the domestic market. While the long-term demand outlook for MMF yarns remain favourable, with an emergence of sportswear, performance wear and athleisure as the major end-use categories, a sustained uptick in demand both in the domestic and export markets will remain important for a revival of DSL's performance in the near-to-medium term. Nevertheless, absence of any long-term debt repayment obligation, an adequate buffer in working capital utilisation and postponement of relatively large capex planned earlier are likely to support DSL's liquidity position. DSL's conservative capital structure, aided by a steady decline in its debt level in the recent years and prepayment of the entire long-term debt in FY2024, also supports the ratings, notwithstanding a deterioration in the debt coverage metrics in FY2024 due to a significant decline in profitability.

The ratings continue to consider DSL's long operational track record of nearly four decades in manufacturing of blended synthetic yarns and its established relationship with customers, which lead to repeat orders and mitigate counterparty risks. ICRA also notes DSL's efficient operations, marked by its high capacity utilisation and the company's cost optimisation initiatives, including expansion of the captive solar power capacity, which are likely to support its cost structure, going forward. The ratings, however, are constrained by the fragmented structure of the spinning industry, leading to competition among many organised and unorganised players, keeping margins under check. DSL's product-market diversity remains moderate, given its presence mainly in the coarse-count yarns segment, a paucity of dying capacity and a modest share of export sales, notwithstanding higher realisations fetched from exports of relatively value-added products. Besides, the company's profitability and cash flows are likely to remain vulnerable to the cyclicality inherent in the textiles sector and the volatility in crude-oil linked raw material prices and realisations.

Key rating drivers and their description

Credit strengths

Long operational track record in manufacturing of blended synthetic yarns – The company's plant at Baddi, Himachal Pradesh commenced operation in 1986. Subsequently, it had set up another plant at Guna, Madhya Pradesh in 1991 and gradually increased capacities of both the plants. Since the beginning, DSL has been involved in manufacturing of blended synthetic yarns. A long track record of operation and experience of the promoters in the industry mitigate DSL's business risks.

Established relationship with customers – DSL sells its products mainly through dealers and agents. In addition, it directly supplies yarns to a few large players in the apparel/fabric segments. The company's established relationship with its customers generates repeat orders and mitigates counterparty risks.

Efficient operations, reflected by high capacity utilisation; expansion of captive solar power capacity and other cost optimisation initiatives likely to support cost structure, going forward – The company's capacity utilisation had historically remained high. The same declined to 82% in FY2021 from 93% in FY2020 due to the pandemic, however, the same improved subsequently and remained in the range of 96-98% in the last three fiscals. DSL has commissioned a new captive solar power plant of 4 megawatt (MW) in its plant in Madhya Pradesh in June 2024, taking its current solar power capacity to 8 MW, which will reduce the power cost of the unit. The company is also focusing on controlling cost, manpower rationalisation etc., which are likely to support its profit margins in future.

Conservative capital structure; long-term loans prepaid in FY2024 – The company's debt level declined gradually since FY2018 with repayment of long-term loans and reduction in working capital borrowings. The gearing declined steadily to 0.2 times as on March 31, 2022 from 1.4 times as on March 31, 2017 and remained low at 0.2 times over the last two fiscals. The debt coverage metrics weakened in FY2024 due to deterioration in profitability. However, the company has prepaid the outstanding long-term loans in FY2024, reducing its debt service obligation.

Credit challenges

Highly fragmented and competitive nature of the industry – The Indian spinning industry is highly fragmented, with the presence of many organised and unorganised players. Competition among the spinners keeps margins under check. Nevertheless, DSL's high capacity utilisation (97% in FY2024) and the presence of captive renewable power sources, which currently meet around 40% of the power requirement of its plant in Madhya Pradesh at a cheap rate, positively impact the cost structure. Besides, the company's operational flexibility to supply customised products to its customers renders competitive advantage to an extent.

Moderate product-market diversity – DSL mainly manufactures coarse-count grey and dyed yarns of 8-30 counts. The product profile is largely commoditised despite the presence of some value-added and usage-specific products ('melange', sewing threads etc). DSL has a dye house in the plant in Himachal Pradesh, but there is no dyeing facility in the plant in Madhya Pradesh, which reduces the scope for value addition in the plant. The company fetches better realisations from export of relatively value-added products. However, the contribution of exports to DSL's overall revenue remains low (12.5% in FY2024).

Exposed to volatility in raw material prices and realisations along with cyclicality inherent in the industry, which is currently passing through a sluggish phase – The company's raw materials mainly comprise staple manmade fibres like polyester, viscose and acrylic fibres, with the major share (97% by volume in FY2024) of polyester in the fibre consumption. Raw material prices and realisations remain highly correlated to crude oil prices and exhibit significant volatility, which along with a cyclical demand pattern for synthetic yarns impact the profitability and cash flows of all the players in the industry, including DSL. The company's performance improved significantly after the pandemic due to a spurt in demand and a sharp rally in realisations, as reflected by healthy revenues and elevated operating margins in FY2022 and H1 FY2023. However, with a slowdown in demand and moderation in realisations, the company's revenues and profitability started normalising from Q3 FY2023. In FY2024, DSL's operating income declined by ~16% due to a drop in its average realisation by ~19%, with softening of crude oil prices, notwithstanding a moderate improvement in sales volume by ~4%. The decline in realisation was higher than the moderation in the average raw material prices (~16%) in FY2024 on the back of an adverse demand scenario, an over-supply situation in the domestic market triggered by slowdown in exports and dumping of cheap yarns and fabric from China, which affected domestic MMF spinners including DSL. A contraction in the spread between average realisation and raw material prices, coupled with the impact of inventory losses with decline in crude oil prices, led to a steady contraction in DSL's operating margin in all the quarters of FY2024. Its operating margin in FY2024 stood at 4.9% in FY2024, down by ~780 basis points from the FY2023 level. In Q1 FY2025, the company posted an operating loss. While the absence of any long-term debt repayment obligation and an adequate buffer in working capital utilisation currently support DSL's liquidity, any further deterioration in profitability and cash flows may adversely impact the liquidity position and the overall credit profile of the company.

Environmental and Social Risks

Environmental considerations: Synthetic materials made from petrochemicals/ crude oil derivatives are not readily biodegradable, resulting in long-term environmental pollution. This may induce higher compliance costs for MMF spinners like DSL considering long-term environmental pollution implications. Besides, environmental risk for spinners arises from the use of water resources for cleaning and for other manufacturing processes like dyeing. DSL has a dyeing facility in one of its units. It complies with environmental regulations. However, the company would remain exposed to tightening environmental regulations related to breach of waste and pollution norms, which can lead to an increase in the operating costs and new equipment/ capacity installation costs.

Social considerations: The social risk for spinning companies emanates from high labour involvement despite increasing mechanisation. The sector is exposed to labour-relation risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. Entities in the spinning sector are also exposed to risks of disruptions due to inability to properly manage human capital in terms of their safety and overall well-being. Shifting in preference towards more environment-friendly alternatives could result in demand-related concerns for MMF spinners in the long term.

Liquidity position: Adequate

DSL's liquidity is likely to remain adequate. Its cash flow from operations declined to Rs. 22.5 crore in FY2024 from Rs. 40.3 crore in FY2023 on the back of decline in its operating margin and is likely to remain under pressure in the current fiscal as well. However, DSL does not have any long-term debt repayment obligation at present as it has prepaid the existing term loans in FY2024. It has also postponed the previously planned large capex of ~Rs. 80 crore. In FY2024, the company incurred a capex of ~Rs. 16 crore, including ~Rs. 11 crore for a 4-MW captive solar plant commissioned in Q1 FY2025. In the current fiscal, the company's capex is estimated at Rs. 10-12 crore, including the residual capex of ~Rs. 4 crore for the solar plant and normal capex, which would be funded internally. The company's GST receivables increased to Rs. 14.6 crore as on March 31, 2024 from Rs. 11.0 crore as on March 31, 2023 due to a higher GST rate on raw materials compared to finished goods for MMF spinners, including DSL, encumbering the company's liquidity to some extent. However, an adequate headroom in working capital utilisation, with an undrawn limit of ~Rs. 17 crore as of April 2024, is likely to support DSL's liquidity, notwithstanding the deterioration in its cash flow from operations.

Rating sensitivities

Positive factors – The ratings are unlikely to be upgraded in the near term, given the adverse industry scenario at present, significantly impacting DSL's profitability. However, specific credit metrics that may lead to ratings upgrade, going forward, include ROCE above 15% on a sustained basis.

Negative factors – ICRA may downgrade DSL's ratings if its revenues and profitability deteriorate further, and its liquidity position worsens. A sustained increase in total debt/OPBDITA above 2.3 times may also trigger ratings downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Textiles - Spinning
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of the rated entity

About the company

Incorporated in 1982 by Mr. Pradip Kumar Daga, Deepak Spinners Limited manufactures blended synthetic spun yarns. The company has two plants at Baddi in Himachal Pradesh and at Guna in Madhya Pradesh with a total spinning capacity of around 37,000 metric tonnes per annum. The Baddi and Guna units have around 41,000 and 54,000 spindles, respectively. Additionally, the Baddi unit has a dye house. The company mainly produces synthetic yarns of 8-30 counts. The Guna plant has captive solar power plants of 8 MW, including an offsite plant of 1 MW. It also draws power from a 5-MW solar power plant of its Group company, Deepak Industries Limited (DIL).

Key financial indicators

DSL (Standalone)	FY2023	FY2024	Q1 FY2025	Q1 FY2024
	Audited	Audited	Unaudited	Unaudited
Operating income	562.2	471.8	139.4	113.1
PAT	40.1	1.3	-5.6	2.2
OPBDIT/OI	12.7%	4.9%	-0.5%	7.0%
PAT/OI	7.1%	0.3%	-4.0%	1.9%
Total outside liabilities/Tangible net worth (times)	0.5	0.5	-	-
Total debt/OPBDIT (times)	0.7	1.9	-	-
Interest coverage (times)	24.9	5.9	-0.7	6.5

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 23, 2024	May 31, 2023	-	Feb 15, 2022
1	Fund Based – Cash Credit	Long term	60.00	**[ICRA]A- (Negative)**	[ICRA]A- (Stable)	-	[ICRA]A- (Stable)
2	Fund Based – Standby Line of Credit	Short term	-	**-**	[ICRA]A2+	-	[ICRA]A2+
3	Fund Based – Export Packing Credit (Interchangeable)*	Short term	(15.00)	**[ICRA]A2+**	[ICRA]A2+	-	[ICRA]A2+
4	Fund Based – Bill Discounting (Interchangeable)*	Short term	(15.00)	**[ICRA]A2+**	[ICRA]A2+	-	[ICRA]A2+
5	Fund Based – Term Loan (Covid loan/CCECL)	Long term	-	**-**	-		[ICRA]A- (Stable)
6	Fund Based – Term Loan	Long term	-	**-**	[ICRA]A- (Stable)	-	[ICRA]A- (Stable)
7	Non-Fund Based – Letter of Credit	Short term	2.00	**[ICRA]A2+**	[ICRA]A2+	-	[ICRA]A2+
8	Non-Fund Based – Capex Letter of Credit	Short term	10.00	**[ICRA]A2+**	[ICRA]A2+	-	[ICRA]A2+
9	Non-Fund Based – Bank Guarantee	Long term	3.00	**[ICRA]A- (Negative)**	[ICRA]A- (Stable)	-	[ICRA]A- (Stable)
10	Non-Fund Based – Credit Exposure Limit	Short term	1.00	**[ICRA]A2+**	[ICRA]A2+	-	[ICRA]A2+
11	Unallocated limit	Long/ Short term	16.10	**[ICRA]A- (Negative) / [ICRA]A2+**	[ICRA]A- (Stable) / [ICRA]A2+	-	-

**Within the overall fund-based working capital limit*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term – Fund Based (Cash Credit)	Simple
Short term – Fund Based – Interchangeable (Export Packing Credit)*	Simple
Short term – Fund Based – Interchangeable (Bill Discounting)*	Simple
Short term – Non-Fund Based (Letter of Credit)	Very simple
Short term – Non-Fund Based (Capex Letter of Credit)	Very simple
Long term – Non-Fund Based (Bank Guarantee)	Very simple
Short term – Non-Fund Based (Credit Exposure Limit)	Very simple
Long term/short term – Unallocated limit	Not applicable

**Within the overall fund-based working capital limit*

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	**Fund Based – Cash Credit**	NA	NA	NA	60.00	[ICRA]A- (Negative)
NA	**Fund Based – Export Packing Credit (Interchangeable)***	NA	NA	NA	(15.00)	[ICRA]A2+
NA	**Fund Based – Bill Discounting (Interchangeable)***	NA	NA	NA	(15.00)	[ICRA]A2+
NA	**Non-Fund Based – Letter of Credit**	NA	NA	NA	2.00	[ICRA]A2+
NA	**Non-Fund Based – Capex Letter of Credit**	NA	NA	NA	10.00	[ICRA]A2+
NA	**Non-Fund Based – Bank Guarantee**	NA	NA	NA	3.00	[ICRA]A- (Negative)
NA	**Non-Fund Based – Credit Exposure Limit**	NA	NA	NA	1.00	[ICRA]A2+
NA	**Unallocated limit**	NA	NA	NA	16.10	[ICRA]A- (Negative)/ [ICRA]A2+

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:

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.

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