



## Ambika Cotton Mills Limited

ICRA has assigned LBB+ (pronounced L double B plus) rating to Rs. 1.86 billion term loans of Ambika Cotton Mills Limited (ACML). This is an inadequate credit-quality rating assigned by ICRA.<sup>†</sup> ICRA has also assigned A4+ (pronounced A four plus) rating to Rs. 1.65 billion fund based limits of ACML. This is the risk prone credit-quality rating assigned by ICRA to short-term debt instruments.<sup>‡</sup>

The rating primarily reflects the stretched financial profile of ACML with weak capital structure and deteriorating coverage indicators. The rating is also constrained by the very high working capital intensity of ACML with a net working capital intensity of more than 70%<sup>‡</sup>. The company's inventory levels are high and while a part of it can be attributed to the diversified requirements of ACML's customers, the primary reason could be attributable to the company's quest for trading gains as witnessed in the past. While the company has benefitted from its inventory policies in the past, stocking/ speculating on cotton price could be risky due to price volatilities which may lead to significant inventory losses. The rating also factors in the difficult textile industry scenario characterized by weakening demand conditions in the export market which poses a threat to the future sales potential of the company.

The rating also takes into consideration the long standing presence of ACML in the spinning industry, efficiency in operations leading to stable profitability till now, diversified product range and established relationship with its customers leading to low order volatility.

ACML is primarily engaged in spinning with a capacity of about one lakh spindles, indicating relatively moderate scale of operations. ACML's product range is diversified across cotton yarn with capability to manufacture Eli-twist cotton yarn, and has presence across the entire count range from 30's to very fine 120's (used in shirting fabric). ACML manufactures cotton from premium indigenous cotton and world renowned Pima and Giza cotton varieties. This, coupled with effective cotton mixing ensures higher quality of yarn at optimum cost resulting in better profitability.

Buoyed by healthy demand witnessed in the past, ACML had gone in for capacity expansion in the recent past which has helped revenue growth. ACML's customer base is diversified across domestic and export markets with ACML being an exclusive supplier to considerable number of its customers. But with significant portion of its sales coming from exports, any further deterioration in the demand conditions would pose a serious threat to the future sales potential of the company.

ACML's primary raw material cotton has displayed high volatility in prices over the last two years but on account of effective raw material procurement coupled with increasing

cotton prices till now ACML has been able to maintain its contribution levels. But on account of huge inventory of cotton, ACML is exposed to significant price risk as any deterioration in cotton prices would significantly impact its profitability. The yarn market is characterized by excess capacities which coupled with expected slowdown in demand may lead to reduction in profitability of spinning units. On account of its established customer relationships ACML has been able to maintain its volumes till now. The perceived better quality of yarn has also minimized the impact of competition and has helped the company attract premium pricing in the market. However if the current scenario of weak demand persists for a longer period, volumes could come under pressure limiting the growth potential of the company.

The operational strengths of ACML have helped the company to maintain stable operating margin till financial year 2008-09 though the market has witnessed an arduous period. As in the case of peers, ACML has been impacted by the power crisis prevailing in Tamil Nadu which had led to the capacity utilization being restricted to 65%.

Supported by revenue growth in the export and domestic market on account of its long standing presence, operating income of ACML has grown at a compounded annual growth rate of 15 per cent over the 2004-09 period. The operating margins have not witnessed much volatility over the same period on account of premium pricing. The company has also been able to manage its costs, through a relatively

<sup>†</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

<sup>‡</sup> Net working capital intensity = Net Working capital/Operating income (NWC/OI)



high risk strategy of speculating on cotton price movements, often leading to large raw material inventory.

ACML has undertaken significant debt funded capital expenditure over past few years for expansion and modernization of yarn capacity and setting up of windmills. This coupled with high utilization of working capital finance to fund its huge inventory of cotton has resulted in a high gearing level of 2.10 times as on March 31, 2009. As a result the net margins, return on capital and debt service indicators have been adversely impacted. ACML's debt repayment obligation for the next two years is high and the debt service coverage indicators are expected to be quite low.

### Company Profile

Ambika Cotton Mills Limited (ACML) is a specialty cotton yarn manufacturer in the premium compact segment. It was started by Mr. Chandran, a first generation entrepreneur in the year 1988. It offers wide range of cotton made out of both indigenously grown and also superior imported raw cotton ("Supima" from USA and "Giza" from Egypt) from various countries. The counts of cotton yarn range from 30's to 120's with the average count being 55's to 65's depending on the demand in the particular month.

ACML has four units and the installed capacity of Unit I is 21648 spindles (of which 12576 spindles are of compact type). Unit II has 20832

spindles, unit III has 24192 spindles and unit IV has 43200 spindles. Units II, III and IV are 100% compact facilities. The total installed spindle capacity of the four plants is 109872 as on date (Compact facility – 100800 spindles representing 91.74% of the total spindle capacity). ACML has a total installed windmill capacity of 15.4 MW.

### Recent Results (Unaudited)

For the first nine months of financial year 2008-09, the company has reported a net profit of Rs. 98.4 million on an operating income of Rs. 1.40 billion.

June 2009

### KEY FINANCIAL INDICATORS

		2005-06	2006-07	2007-08
Net Sales		1049.0	1405.0	1557.4
OI		1064.4	1428.8	1627.5
OPBDITA		354.7	448.1	464.2
PAT		189.7	173.2	132.4
Equity Capital		58.8	58.8	58.8
Net Worth#		974.5	982.6	1112.1
PAT/OI	%	17.83	12.12	8.13
PBIT/ Avg. (Total Debt + NW + DTL – CWIP)	%	12.55	11.99	8.98
OPBDITA/Interest and Finance Charges	Times	5.57	4.73	3.57
NCA/Total Debt	%	18	13	9
Total Debt/NW	Times	1.53	2.17	2.59
Current Ratio	Times	1.48	1.46	1.44

Note: Amounts in Rs. Million

CWIP: Capital Work-in-Progress; OI: Operating Income; OPBDITA: Operating Profit before Depreciation, Interest, Tax and Amortisation; PAT: Profit after Tax; PBIT: Profit before Interest and Tax; NCA: Net Cash Accruals; NW: Net Worth; #not adjusted for goodwill



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