

Aarti International Limited

January 31, 2019

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	233.40	233.40	[ICRA]A-(Stable); reaffirmed
Term Loans	165.07	165.07	[ICRA]A-(Stable); reaffirmed
Letter of Credit	25.30	25.30	[ICRA]A2+; reaffirmed
Bank Guarantee	2.00	2.00	[ICRA]A-(Stable); reaffirmed
Long-term/Short-term Interchangeable	(233.40)	(233.40)	[ICRA]A-(Stable)/ [ICRA]A2+; reaffirmed
Total	425.77	425.77	

**Instrument details are provided in Annexure-1*

Rationale

The rating action takes into account AIL's established track record of more than two decades in the cotton spinning industry, its large-scale operations with a single location spinning capacity of 175,000 spindles, a wide product portfolio of basic and value-added yarns, and satisfactory operational performance corroborated by consistently healthy utilization of the spinning mill. The ratings also draw comfort from AIL's financial flexibility by virtue of being a part of the Ludhiana-based Aarti Group.

While reaffirming the ratings, ICRA has considered the significant increase in AIL's debt levels during FY2018 from a multi-year low in March 2017 owing to debt-funded capacity addition. Further, this increase in debt was accompanied by a sharp decline in profitability due to industry-wide pressures led by temporary demand disruptions and firm cotton prices. As a result, the company's debt metrics weakened in FY2018. Nevertheless, the debt metrics have recovered subsequently with a healthy recovery in profitability in current year, supported by strong revival in contribution margins of spinning division, and improved contribution of new fabric knitting and processing capacities. ICRA expects the company to report Total Debt/OPBDITA of less than 4 times and interest cover of more than 3 times in FY2019 vis-a-vis 7 times and 2.7 times respectively in FY2018. Moreover, long tenure of debt (door to door tenure of ~9 years) together with ballooning repayments of the new term loans and falling repayments of existing term loans, is expected to keep the company's financial profile comfortable, with a minimum DSCR of 1.7 times during FY2019-FY2021.

The ratings, however, continue to be constrained by AIL's high working capital intensity of operations, which like other spinning companies, is on account of seasonal nature of cotton availability that necessitates stocking during the harvest season. The stocking requirement will continue to keep the dependence upon debt high and profitability vulnerable to volatility in the cotton prices. Further, ICRA notes that the commoditized nature of yarn and intense competition in the industry due to its fragmented nature will continue to keep the profitability under check. Moreover, as AIL continues to derive a large share of its revenues from exports (though the dependence upon exports has declined considerably in past two years), the earnings remain dependent on its ability to effectively hedge its export receivables on a consistent basis, besides the demand trend in export markets.

Outlook: Stable

The Stable outlook reflects ICRA's expectation that AIL will maintain its established market position in the spinning industry and continue to benefit from its large scale and improving level of integration. Despite the increase in debt obligations due to the recently concluded capex, the debt protection metrics are expected to remain comfortable supported by recovery in performance of the spinning division, contribution from new capacities, and long tenure of new term loans. The outlook may be revised to 'Positive' in case of better than expected trajectory in debt coverage indicators. The outlook may be revised to 'Negative' in case of sustained weakness in profitability or large debt funded capital expenditure impacting the cash flows and liquidity.

Key rating drivers

Credit strengths

Large scale spinning operations with an established market position and sizeable presence in value-added products - AIL is a Ludhiana (Punjab)-based spinner having a single-location capacity of 1.75 lakh spindles, which is large compared to an average capacity of ~28,000-30,000 spindles per unit in India. The large scale in yarn manufacturing augurs well for cost structure in a commoditised market. The company manufactures pure cotton and blended spun-yarn across a wide count range, with 30s and 32s counts accounting for majority of the production. In addition to the basic grey yarn, the company also manufactures value-added yarns. The ability to manufacture a diversified product range across various counts and varieties not only improves the value addition but also provides some flexibility to switch among product offerings, depending upon the demand scenario.

Healthy operational performance, corroborated by consistently high utilization of the spinning mill - Given the established market position in the industry with long standing relationships with clients and value-added product profile, AIL's spinning unit's production levels have remained healthy with >95% capacity utilization in most years. While AIL's capacity utilization had declined to ~90% in FY2017 due to country-wide decline in yarn exports, the production levels recovered thereafter as reflected by capacity utilization level of 101% in FY2018 and 106% in 7MFY2019. The recovery in AIL's production volumes has been supported by recovery in export volumes (despite India's overall cotton yarn export volumes remaining under pressure during the year), improved traction in domestic market and increased captive consumption in the knitted fabrics division.

Financial flexibility by virtue of being a part of the Ludhiana-based Aarti Group - AIL is a part of the Ludhiana-based Aarti Group that is led by Mr. Shiva Prasad Mittal. Aarti Group also has interests in iron & steel business through Aarti Steels Limited¹ (ASL), and in warehouse consignment business through Salig Ram Shiv Parshad (SRSP). The group has also established a charitable hospital (Deepak Memorial) in Ludhiana. Deepak Memorial is a Multi-Specialty hospital with 24X7 medical emergency facilities. The group also operates a cinema in Ludhiana. The promoters have been actively engaged in operations of the steel and textile businesses for over two decades.

Credit weaknesses

Leveraged capital structure - Given the fixed as well as working-capital intensive nature of operations, AIL's financial leverage, similar to other domestic spinning companies, has remained high over the years. Further, while the company's debt obligations had declined steadily for four consecutive years till FY2017, these increased again in FY2018 due to debt-funded capex. Thus, notwithstanding the strong recovery in profitability estimated for FY2019 and resulting

¹ ICRA has [ICRA]A+(Stable)/[ICRA]A1 ratings outstanding for the bank facilities of Aarti Steels Limited. For details, please refer to ICRA's website – www.icra.in

improvement in debt metrics, AIL's financial profile is expected to remain leveraged as reflected by expected Total Debt/OPBDITA of about 3.6 times for FY2019. Nevertheless, ICRA believes that AIL's cash flow profile will remain comfortable due to favorable term debt profile with long tenure (door to door tenure of ~9 years). Besides, the ballooning repayments of new term loans will coincide with a sharp fall in repayments of existing term loans. Resultantly, AIL's financial profile is expected to remain comfortable, with a minimum DSCR of 1.7 times during FY2019-FY2021.

Susceptibility to volatility in cotton and cotton yarn prices, and currency movements - Similar to other entities in the spinning sector, AIL stocks cotton during the harvest season, which is from October to March. This stocking of cotton exposes the company to the fluctuations in cotton and hence cotton yarn prices during the non-harvest period as the procurement cost for the company gets fixed. This also results in a high dependence upon working-capital borrowings and hence keeps the leverage high, particularly at the year-end. Further, as AIL derives about 35% of its revenues from exports, its profitability remains dependent on its ability to effectively hedge its export receivables on a consistent basis and also on the demand in export markets.

Commoditized nature of yarn coupled with fragmented industry structure keep profitability under check - The spinning and knitting industries are highly fragmented with a significant share of the unorganised segment. While AIL manufactures a wide variety of products encompassing yarns with varying levels of value addition and knitted fabrics, its product portfolio continues to be concentrated towards medium-count and low to medium value-added yarns and fabrics. As a result, it enjoys limited pricing power, which is likely to keep its profitability under check.

Liquidity position

AIL's liquidity profile remains satisfactory, though the cushion has moderated during the past one year owing to sizeable cash outgo towards capex and higher cotton stocking in past twelve months amid expectations of uptick in cotton prices. This is reflected by an average working capital limit utilisation of 83% over the past twelve months compared to an average utilisation level of about 50% in the previous twelve months. Nevertheless, the ongoing strong profitability/cash accruals and completion of capex are likely to support rebuilding of liquidity cushion over the next few quarters. Further, ICRA notes that AIL enjoys financial flexibility by virtue of being a part of the Ludhiana-based Aarti Group.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Indian Textiles Industry– Spinning
Parent/Group Support	Not Applicable
Consolidation / Standalone	Standalone

About the company:

Aarti International Limited (AIL), incorporated in 1994, is a Ludhiana-based manufacturer of ring-spun yarns and knitted fabrics. The company has a large single-location spinning capacity of 1.75 lakh spindles, whereby it manufactures cotton and blended spun-yarns, with a focus on medium counts. To achieve partial forward integration, AIL forayed into fabric knitting with commissioning of 15 knitting machines in FY2017. The company has thereafter installed a fabric processing capacity of about 5.8 million kgs per annum and has enhanced the fabric knitting capacity to 39 looms (about 6.8 million kgs per annum).

AIL is part of the Ludhiana-based Aarti group that also has interests in iron and steel business through Aarti Steels Limited (ASL), which manufactures sponge iron, steel billets/ingots, rounds and bars, steel wires and ferro alloys and has captive power-generation capacity.

Key Financial Indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	H1FY2019 (Provisional)
Operating Income (Rs. crore)	672.99	670.40	751.98	427.53
PAT (Rs. crore)	21.37	23.59	9.15	28.48
OPBDIT/ OI (%)	12.48%	12.33%	8.29%	15.31%
RoCE (%)	9.22%	9.46%	5.91%	13.14%
Total Debt/ TNW (times)	1.41	0.85	1.34	1.18
Total Debt/ OPBDIT (times)	4.72	3.22	6.92	3.15*
Interest coverage (times)	2.52	3.36	2.72	3.65
NWC/ OI (%)	57%	42%	46%	39%*

*Note: OPBDIT: Operating Profit before Depreciation, Interest and Taxes; ROCE (Return on Capital Employed): Profit before Interest and Tax (PBIT)/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital
not exactly comparable to March-end figures as inventory and working capital debt is lowest in September and highest in March due to seasonal stocking of cotton.

Source: AIL's Annual Reports, ICRA estimates

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016	
					Jan 2019	Feb 2018	Dec 2016	Oct 2015	
1	Cash Credit	LT	233.40	-	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	
2	Term Loans	LT	165.07	154.68 [^]	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	
3	Letter of Credit	ST	25.30	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	
4	Bank Guarantee	LT	2.00	-	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	
5	Long-term/ Short-term/ Interchangeable	LT/ST	(233.40)	-	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	

**as on March 31, 2018; Note: LT: Long-term; ST: Short-term*

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	233.40	[ICRA]A-(Stable)
NA	Long-term/ Short-term Interchangeable	-	-	-	(233.40)	[ICRA]A-(Stable)/ [ICRA]A2+
NA	Letter of Credit	-	-	-	25.30	[ICRA]A2+
NA	Bank Guarantee	-	-	-	2.00	[ICRA]A-(Stable)
NA	Term Loan 1	Jun 2017	-	Sep 2026	20.00	[ICRA]A-(Stable)
NA	Term Loan 2	Jul 2017	-	Sep 2026	35.00	[ICRA]A-(Stable)
NA	Term Loan 3	Sep 2017	-	Sep 2026	10.00	[ICRA]A-(Stable)
NA	Term Loan 4	May 2017	-	Mar 2024	40.00	[ICRA]A-(Stable)
NA	Term Loan 5	FY2010	-	FY2024	60.07	[ICRA]A-(Stable)

Source: AIL

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

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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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