



## RAJ INDUSTRIES

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### Rating

ICRA has revised its long-term rating on the Rs. 19.00 crore cash credit limit (enhanced from Rs. 14.00 crore) of Raj Industries to [ICRA]A- (pronounced ICRA A minus) from [ICRA]BBB+ (pronounced ICRA triple B plus). The outlook on the long-term rating is 'Stable'. Further, ICRA has revised its short term rating on the Rs. 17 crore inland / foreign letter of credit limits to [ICRA]A2+ (pronounced ICRA A two plus) from [ICRA]A2 (pronounced ICRA A two).

### Key Financial Indicators

Particulars	Units	9M 2014-15	2013- 14	2012-13
Operating Income	Rs. Cr.	286.00	295.33	279.40
OPBDITA	Rs. Cr.	19.77	29.65	17.72
PAT	Rs. Cr.	16.90	25.16	11.89
NCA	Rs. Cr.	19.32	23.66	13.99
Total Debt	Rs. Cr.	3.75	16.83	16.98
Tangible Net Worth	Rs. Cr.	64.99	53.16	33.02
OPBDITA/OI	%	6.91%	10.04%	6.34%
PAT/OI	%	5.91%	8.52%	4.26%
RoCE	%	33.85%	43.60%	31.06%
RoNW	%	38.14%	58.40%	42.92%
Total Gearing	Times	0.06	0.32	0.51
OPBDITA/Interest & Finance Charges	Times	27.85	37.64	7.49
NCA/Total Debt	%	686%	141%	82%
Total Debt/OPBDITA	Times	0.14	0.57	0.96
Debtor days	Days	14	17	10
Creditor days	Days	12	4	9
Inventory days	days	20	32	31
NWC/OI	%	11%	16%	10%

#### Source: Entity Financial Statements and ICRA Analysis

*Note: OPBDITA: Operating Profit before Depreciation, Interest, Tax and Amortisation; OI: Operating Income; PAT: Profit after Tax; NCA: Net Cash Accruals; NWC: Net Working Capital; PBIT: Profit before Interest & Tax*

*RoCE (Return on Capital Employed) = PBIT / Avg. (Total Debt + Total Net Worth + Deferred Tax Liability – Capital Work-In-Process)*

*RoNW (Return on Net Worth) = PAT / Avg. (Total Net Worth + Minority Interest)*

#### Website

[www.icra.in](http://www.icra.in)

## Key Rating Considerations

### Credit Strengths

- ❑ Significant capacity increase in FY 15 through debottlenecking thus leading to growth in revenues
- ❑ Long experience of promoters of over five decades in the soap manufacturing industry
- ❑ Established relationships with major domestic soap marketers such as ITC, Reckitt Benckiser, etc.
- ❑ Fiscal benefits such as income tax / excise exemption from the Government of Himachal Pradesh till 2017
- ❑ Healthy financial risk profile characterised by healthy return indicators, robust gearing and debt coverage indicators

### Credit Concerns

- ❑ End-user toilet soap industry has achieved high penetration and hence, growth outlook is modest
- ❑ Low bargaining power with customers due to smaller scale of operations
- ❑ High customer concentration risks
- ❑ Withdrawal of fiscal benefits after 2017 may impact profitability to that extent
- ❑ Vulnerability of profitability to foreign exchange fluctuations and raw material price risks, given that part of raw materials are imported
- ❑ Moderation in profitability in recent years

## Rating Rationale

The revision in ratings takes into account the significant increase in the firm's capacity in FY15, which has been achieved through debottlenecking and process changes and has been funded by internal accruals; given the robust demand for its products, this has translated into strong growth in revenues. This has been backed by favourable working capital movements, which have resulted in a significant improvement in the firm's cash flows for the nine months ended December 31, 2015, which have also resulted in an improved liquidity position. The firm's gearing has also improved to 0.06 times as on December 31, 2014 from 0.32 times as on March 31, 2014. The ratings also take into account the firm's healthy capacity utilisation and its established relationships with national & regional toilet soap marketers and growing demand of own brand. The ratings are, however, constrained by the modest growth outlook for the end-user toilet soap industry in the domestic market due to high market penetration levels. ICRA further notes that the firm faces high customer concentration risks, with its top two customers accounting for ~66% of the firm's revenues for the nine months ended December 31, 2014. Further, the firm's profitability is vulnerable to fluctuation in prices of key raw material whose prices are further linked to global crude oil prices, given that part of the raw material requirements is imported. ICRA also notes that the being a partnership firm, the capital structure of the firm is vulnerable to withdrawal of capital by the partners, although significant amount of capital has not been withdrawn in the past. Further, ICRA notes that the fiscal benefit will be withdrawal after 2017. Going forward, the ability of the firm to sustain its revenues and profitability while maintaining its healthy liquidity position and capital structure will remain the key rating sensitivities. Any substantial withdrawal of capital by the partners or significant debt-funded capital expenditure may put downward pressure on the ratings.

## Entity Profile

Raj Industries (RI) is a partnership entity of the Bansal family of Ludhiana and was set up in April 2007. The promoter, Mr. Raj Paul Bansal, has been in the industry for over five decades and set up a unit for manufacturing laundry soap in 1956 named National Soap Mills, which is currently operational and has a manufacturing capacity of 10,000 metric tonnes per annum (MTPA). Subsequently, he also set up another company named Raj Soap and Detergents Pvt. Ltd. in 1987, which is engaged in manufacturing synthetic detergent-based cleaning products and the said unit has been merged with National Soap Mills in FY 12-13. RI is in the business of manufacturing and sales of toilet soap, laundry soap, soap noodles, industrial monocarboxylic fatty acids and related products / by-products such as pitch, residue and crude glycerine. It has its registered office in Ludhiana, while the plant is located in Nalagarh (Himachal Pradesh) to avail of fiscal incentives in the form of income tax / excise duty exemptions by the Government of Himachal Pradesh. The firm sells soap noodles to soap manufacturers such as ITC Ltd., Reckitt Benckiser and also

sells toilet soaps under its own brands – Raj and Raj No. 1. The current manufacturing capacity of the firm stands at 95,000 metric tonnes per annum (MTPA) and the capacity is currently being fully utilised.

## Business & Competitive Position

### **Modest growth outlook for toilet soap due to high penetration levels in the domestic market**

Oleo chemicals are chemical products such as fatty acids, fatty alcohols, glycerine, etc. derived from animal or vegetable triglycerides. Globally, the oleochemicals market is dominated by South-East Asia due to strong demand growth in the Asia Pacific region and availability of raw materials (particularly in Indonesia and Malaysia). Fatty acids are used to a large extent in the production of toilet soaps. Most of the domestic companies in the soap noodles segment utilise fatty acids for in-house toilet soap production, except for a few entities (such as RI, Jocil Ltd., VVF (India) Ltd.) supplying soap noodles to external entities for soap manufacturing.

The domestic toilet soap market has several national and global brands as well as a large number of regional brands. The market is saturated with high market penetration levels of 98%, primarily driven by increased awareness about personal hygiene. While penetration of soaps in the country is high, per capita consumption at ~0.6 kg remains low vis-a-vis most other countries. Given the high penetration levels and brand proliferation, the market is expected to grow at modest rates of 4-4.5% largely driven by value growth.

### **Healthy capacity utilisation levels**

The firm's product profile comprises primarily of soap noodles and finished soap, while fatty acid production is entirely being utilised in-house. The capacity of the entity increased to 95,000 MTPA (fatty acid + soap noodles capacity) from 75,000 MTPA during the past two years driven by increase in operating efficiencies. The company till Dec-14 has achieved capacity utilization of ~96% (on the basis of capacity of 81000 MTPA) and till Feb-15, the company has achieved production of 94431 MTPA.

Capacity Utilisation Trends

Particulars	Units	FY10	FY11	FY12	FY13	FY14	FY15 (9M)	FY15 (11M)
<b>Installed Capacity</b>	<b>MTPA</b>	<b>75,000</b>	<b>75,000</b>	<b>75,000</b>	<b>75,000</b>	<b>81,000</b>	<b>81,000</b>	<b>95,000</b>
Production	MT	38,498	49,547	64,849	76,211	80,797	77,943	94,431
- Fatty Acid Plant	MT	16,868	21,075	27,864	32,807	34,023	32,193	38,934
- Soap Plant	MT	21,630	28,472	36,985	43,404	46,774	45,750	55,497
<b>Capacity Utilisation</b>	<b>%</b>	<b>51%</b>	<b>66%</b>	<b>86%</b>	<b>102%</b>	<b>100%</b>	<b>96%</b>	<b>99%</b>

(Source: Entity Info, ICRA Analysis)

### **Increase in sales to national level soap marketers; however, high customer concentration and low bargaining power with major customers**

The firm has three modes of marketing its products:

1. Sales of soap noodles to national level soap marketers
2. Sales of soap noodles / finished soap to regional players
3. Retail sales under its own brand / sales of by-products (such as glycerine)

The entity sells soap noodles to major domestic soap marketers such as ITC Ltd., Reckitt Benckiser, Wipro Consumer Products, etc., as well as to regional players such as BN Agencies, etc. Some of these players have plants in Himachal Pradesh in proximity to the entity's unit, leading to low transportation costs. These companies purchase soap noodles from the firm, while soap finishing and packaging is largely done at their own units. Besides, the firm has its own marketing and distribution network comprising of 500 dealers in the states of Punjab, Rajasthan, Jammu, Delhi, Haryana, western part of Uttar Pradesh and Madhya Pradesh. The entity markets finished toilet soap under the brand name of 'Raj' and 'Raj No. 1' through its retailer network. It also sells certain by-products obtained from the saponification process, such as glycerine.

### **Profitability and contribution levels are vulnerable to fluctuations in raw material prices and foreign exchange rates; firm hedging policy**

The major raw materials for the firm includes crude edible oils (such as palm and rice bran), which are used for the production of fatty acids. These oils are increasingly being sourced from local edible oil refineries, although RI does import part of the requirements. The contribution levels and in turn, operating profitability has fluctuated in response to fluctuations in raw material prices, which are driven by fluctuations in edible oil supply and demand trends. While the firm has back-to-back arrangement with suppliers and customers, the profitability remains vulnerable to fluctuations in raw material prices given that retail prices for FMCG end-consumers are not changed frequently. Further, given that part of the raw material requirements are imported (~16% in FY15 (till Dec-14)), the profitability is also vulnerable to foreign exchange fluctuations. Nevertheless, the entity has a firm hedging policy of completely hedging its imports through forward contracts, which mitigates the forex risks.

#### ***Fiscal incentives from Himachal Pradesh government aids profitability***

As per incentives offered by the Himachal Pradesh government, the unit is entitled to get certain fiscal benefits, such as exemption from excise duty and income tax benefits. While excise duty exemption is applicable till a period of 10 years from inception, i.e. till 2017, the unit is income tax exempt to the extent of 25% for the original capacity from FY13 onwards and to the extent of 100% for the expanded capacity till FY15 (i.e. for a period of five years since expansion), after which the same will also be 25% tax exempt till 2017. The fiscal incentives have aided the firm's profitability to some extent, although part of the benefits are passed on to the customers in the form of favourable pricing. The profitability of the firm may be impacted to some extent once these benefits are withdrawn in 2017.

#### ***Capex plans***

No major capex is expected at the existing unit of the entity in the near term. The promoters may set up another unit in southern India over the next two years, but the plan is still in a nascent stage and has not been factored in the assigned ratings. ICRA will review the ratings once the entity finalises these investments and there is more clarity on the funding structure for the project.

### **Financial Risk Profile**

#### ***Profitability and return indicators***

In FY15, till Dec-14, the company has achieved sales revenue of Rs. 286 crore (up to 28-Feb-2015, the company has achieved sales revenue of Rs. 345.70 crore) and expected to close FY15 with total revenue of over Rs. 350 crore, thus expecting to show a growth of 18% as compare to the previous year. This growth in operating income will be on account of growth in production volume to 95000 MTPA against 81000 MTPA in the previous year and improvement in realization of over 6%. Though the company at present is operating at 100% capacity utilization level but the management has taken steps to use up soap vapours, which earlier used to evaporate, but are now re-introduced in the system, which has led to some increase in production levels. Besides, an additional boiler has been installed for back-up to ensure no outages. These measures will help entity to achieve the over production in FY15.

The operating profitability witnessed a decline from 10.04% in FY14 to 6.91% in FY15 on account of increase in raw material cost because of sudden crash in the global crude oil prices; (vegetable oil the key raw material) in the last few months has led to downward correction in the final selling price of the finished goods vis-à-vis high cost inventory. But the management expects the contribution to improve going further on account of procurement of key material on lower prices because of continuing downfall in prices of crude oil.

Further, the company reported net profit of Rs. 16.90 crore in FY15, showing net margins of 5.91%. The net margins have dropped on account of decline in operating profitability, and increase in interest expense & depreciation (on per annum basis).

#### ***Capitalization and Coverage Indicators***

As on December 31, 2014, the total debt of Rs. 3.75 crore mainly compriseS of working capital borrowings and unsecured loan of Rs. 0.50 crore. Further with healthy profitability and limited withdrawals, the net worth has improved to Rs. 64.99 crore as of December 31, 2014 from Rs. 53.16 crore as of end-FY14. On

the other hand, borrowings levels have significantly reduced. Consequently, gearing has improved from 0.32 times as of end-FY14 to 0.06 times as of December 31, 2014.

**Capital structure of the concern is vulnerable to withdrawal of capital, although withdrawals have remained limited in the past**

The firm is a partnership concern, which renders it vulnerable to the withdrawal of capital by the promoters. Since the earnings are not necessarily retained in the business, the capital structure and debt coverage indicators of the firm may be impacted in case of higher withdrawals. Nevertheless, withdrawals from the firm have remained modest over the years FY10-FY15.

**Capital Infusion / Withdrawal and Gearing Levels**

Particulars	Units	FY10	FY11	FY12	FY13	FY14	FY15 (as on 31-Dec-14)
Opening Capital	Rs. Cr.	8.39	15.67	18.51	22.40	33.02	53.16
Net Profit	Rs. Cr.	6.44	4.71	6.65	11.89	25.16	16.90
(Withdrawal)/Infusion	Rs. Cr.	0.85	-1.87	-2.76	-1.27	-5.03	-5.07
Ending Capital Balance	Rs. Cr.	15.67	18.51	22.40	33.02	53.16	64.99
Total Debt	Rs. Cr.	20.17	24.51	23.46	16.98	16.83	3.75
Gearing	Times	1.29	1.32	1.05	0.51	0.32	0.06

(Source: Entity Info, ICRA Analysis)

**Robust coverage indicators due to healthy profitability and low debt levels**

The coverage indicators have remained healthy over the years given the moderate profitability and limited borrowings. As on December 31, 2014, the interest cover is of 27.85 times, NCA/Debt of 686% and Total Debt/OPBDITA of 0.14 times.

**Moderate working capital intensity; comfortable liquidity position**

The entity's working capital intensity has remained low at 10-12% due to low debtor days. The major customers of the entity are located in close proximity to its plant, which leads to low transit time. The firm provides credit period of 15-30 days only to major customers such as ITC, while its retail sales and sales to other buyers are based on cash payment. The supplies are also made based on cash payment, with the entity obtaining limited credit period from its suppliers. The entity maintains a raw material inventory of 15-20 days generally. Due to the small operating cycle, the working capital intensity has remained low. Given the moderate working capital intensity, the liquidity position has remained comfortable as reflected by the limited utilisation of fund-based and non-fund based limits in recent years.

**Prospects**

Going forward, ICRA expects the capacity utilisation level of the entity to remain at optimum levels, which should result in revenues of the entity to remain largely stable in the medium term. Profitability remains vulnerable to fluctuations of edible oil prices, although measures to reduce costs may lead to moderate operating profitability levels. Liquidity position of the firm should remain comfortable given the moderate working capital cycle. ICRA anticipates that the key credit metrics of the entity should continue to remain healthy in the near-to-medium term. The ability of the firm to sustain its revenues and profitability while maintaining its healthy liquidity position and capital structure would remain the key rating sensitivities. Any substantial withdrawal of capital by the partners or significant debt-funded capex may put downward pressure on the ratings.

**March 2015**

**Annexure - 1****Ratings**

<b>Instrument</b>	<b>Amount in Rs. Crore</b>	<b>Rating Action</b>
Fund-based, Long-term facilities	19 (enhanced from Rs. 14 crore)	Revised to [ICRA]A-(Stable) from [ICRA]BBB+(Stable)
Non-fund Based, Short-term facilities	17	Revised to [ICRA]A2+ from [ICRA]A2



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