

August 26, 2019

Duroflex Private Limited: Ratings reaffirmed; outlook revised to Positive from Stable, rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loan	27.00	25.50	[ICRA]A- (Positive); Reaffirmed Outlook revised to Positive from Stable
Long-term Fund Based	25.00	30.00	[ICRA]A- (Positive); Reaffirmed Outlook revised to Positive from Stable
Short-term Non-fund Based	20.00	27.00	[ICRA]A2+; Reaffirmed
Long-term/Short-term Unallocated	0.00	1.50	[ICRA]A- (Positive)/ A2+; Reaffirmed Outlook revised to Positive from Stable
Total	72.00	84.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in outlook favourably factors in the Rs. 74-crore equity infusion in FY2019 from a private equity investment fund, which will enable Duroflex to invest in its expansion plans and maintain comfortable capitalisation and coverage metrics. Backed by expansion into newer geographies and increase in focus on marketing and brand building, Duroflex reported revenue growth of 28% in FY2019, which is higher than the estimated growth in the mattress industry. ICRA expects Duroflex to grow faster than the market on the back of expansion in the western and eastern Indian markets, where it plans to set up of new manufacturing facilities.

The ratings continue to draw comfort from the established presence and the strong brand presence of Duroflex Private Limited (Duroflex, the company) in the mattress industry in South India. The company has strong credit metrics, with low debt levels (Rs. 16.9 crore as on March 2019) and high bank balances (Rs. 86.1 crore as on March 2019), which would help expand its presence in western and eastern India.

The ratings are, however, constrained by the highly competitive industry, which is dominated by unorganised players as well as large organised players, thereby restricting the company's margins. In FY2019, the company's operating margin declined to 6.11% from 8.68% in FY2018 because of higher spending on selling and employee expenses as the company expanded geographically. Moreover, the profit margins are exposed to fluctuations in input prices, which are linked to the prevailing supply and demand dynamics, movement in crude oil prices and fluctuations in exchange rates. Any increase in input costs could impact the company's profitability as it may not be able to immediately pass on the price increase entirely in the mattress business. Nonetheless, the price of a key raw material, TDI, has dropped significantly since the last quarter of FY2019, which should enable improvement in profitability in H1FY20. The company is also exposed to geographic concentration risks as 85% of the sales are derived from South India. The ability of the company to maintain its growth momentum in the wake of tepid demand in the country, without compromising on profitability would be a key monitorable.

Outlook: Positive

ICRA believes Duroflex will continue to show healthy sales growth, supported by its well-established brand name and expansion of its sales network in new geographies to capture additional market share. The outlook may be revised to Stable or Negative in case of further deterioration in profitability indicators or if larger-than-expected debt-funded capital expenditure significantly deteriorates the debt coverage indicators. The rating may be upgraded in case the financial risk profile strengthens, supported by improvement in sales from the new geographies and better profitability indicators through higher economies of scale and improved pricing power.

Key rating drivers

Credit strengths

Long track record of operations and established brand in South India- The company is a leading manufacturer of mattresses in South India, with presence of over five decades in the industry. The company has an established brand name in south India and accounts for around 85% of the revenues. It manufactures rubberised coir, spring, PU foam and latex foam mattresses apart from PU foam-based products, which find application in a wide range of industries. The company has around 8% market share in the Indian mattress industry.

Strong revenue growth in recent years - The company has registered a growth of 33% in mattress sales and 24% in PU foam sales, which are higher than the average growth rate of 8-10% in the mattress industry. Duroflex has adopted the strategy of having more exclusive business outlets, which has helped the company to achieve 30% volume growth in mattress sales in FY2019.

Financial risk profile characterised by robust debt coverage indicators- Duroflex has strong debt coverage indicators as evidenced by the gearing of 0.12 times, Total Debt/OPBITDA of 0.68 times, interest coverage ratio of 4.42 times and debt service coverage ratio of 2.93 times as on March 31, 2019 (based on provisional financials). The strong credit profile is supported by cash and bank balances of Rs 86.1 crore as on March 2019.

Equity raised in FY2019 to support growth plans - Duroflex received fresh equity of Rs 74 crore from Lighthouse Fund, a private equity fund, in FY2019. The equity raised will be utilised for meeting the company's expansion plans. The strong equity base is expected to result in comfortable capitalisation metrics for the company, notwithstanding its high capex plans over the long term.

Credit challenges

Moderate scale of operations; geographic concentration in South India- With a turnover of Rs 400 crore in FY2019 on a standalone basis, the scale of the company remains moderate in the competitive mattress industry. The company faces geographic concentration in south India, with 85% of the revenues derived from Karnataka, Kerala, Tamil Nadu, Andhra Pradesh and Telangana. The company faces intense competition as the mattress industry continues to be dominated by unorganised players that manufacture coir, cotton and low-priced foam mattresses. The company also faces competition from other leading organised players such as Sheela Foam, Kurlon and Peps. Nonetheless, the company is slowly expanding in other geographies and the fresh equity received will be utilised to improve its manufacturing capabilities and sales network.

Low profitability due to investments in expanding geographic presence- The competitive nature of the industry constraints the profit margins of Duroflex. In addition, the profit margins have been impacted by the high selling costs incurred to gain market share from organised and unorganised players in the new geographies as well as by the increased employee expenses towards strengthening sales operations in the new markets. Consequently, Duroflex’s operating profit margins declined to 6.11% in FY2019 from 8.68% in FY2018.

Exposure to fluctuations in raw material prices- The prices of key raw materials needed for production of foam, TDI and polyol, which are by-products of crude-oil, have seen substantial fluctuations over the past two years. Additionally, the prices are also linked to the demand and supply conditions prevailing in the market. Though the company has a diversified set of suppliers, the company faces the risk of reduced availability or unavailability of the raw materials as there are limited number of suppliers in the world.

Liquidity position: The liquidity profile of the company is strong, supported by cash balances of Rs 86 crore and unutilised working capital limits of Rs 23.5 crore as on March 31, 2019, on account of the fresh equity infusion of Rs 74 crore in FY2019. Further, annual cash accruals of Rs 20-30 crore are adequate to cover the debt service obligations, incremental working capital requirements as well as routine capex. The large project capex pertaining to expansions in newer markets are expected to be funded through a mix of available liquidity and fresh term loans.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation / Standalone	Rating is based on standalone financial statements of the company

About the company:

Incorporated in 1963, Duroflex is one of the leading manufacturers of mattresses in South India. It manufactures rubberised coir, PU foam and spring mattresses. Further, the company also manufactures PU foam for use in a wide range of industries. It also sells other home comfort products such as pillows, bedspreads, cushions, protectors, and comforters. At present, the company owns and operates three manufacturing facilities in India— Anekal, Karnataka; Hosur, Tamil Nadu and Nacharam, Hyderabad. In October 2018, the company received an investment from Lighthouse PE Fund for a minority stake of 23%. The company plans to use the funds to expand its operations.

Key financial indicators

	FY2018	FY2019 (Provisional)
Operating Income (Rs. crore)	317.60	405.87
PAT (Rs. crore)	11.73	10.52
OPBDIT/OI (%)	8.68%	6.11%
RoCE (%)	37.15%	19.03%
Total Debt/TNW (times)	0.65	0.12
Total Debt/OPBDIT (times)	1.27	0.68
Interest coverage (times)	12.19	4.42

Status of non-cooperation with previous CRA: CRISIL in its rationale published on July 25, 2018 had reviewed the rating assigned to the bank facilities of Duroflex Private Limited and revised it to CRISIL BB+/Stable/CRISIL A4+ Issuer Not Cooperating, which was subsequently withdrawn on February 4, 2019 at the company's request post receipt of no dues certificate and no objection certificate from the banks.

Any other information: None

Rating history for last three years:

		Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years			
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Aug 2019	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	
								1
2	Fund-based	Long Term	30.00	-	[ICRA]A-(Positive)	[ICRA]A-(Stable)	-	-
3	Non-fund based	Short Term	27.00	-	[ICRA]A2+	[ICRA]A2+	-	-
4	Unallocated	Long Term/Short Term	1.50	-	[ICRA]A-(Positive)/A2+	-	-	-

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Long-term Term Loan	Aug-17	-	Apr-24	25.50	[ICRA]A- (Positive)
-	Long-term Fund Based	-	-	-	30.00	[ICRA]A- (Positive)
-	Short Term- Non-fund Based	-	-	-	27.00	[ICRA]A2+
-	Long-term/Short-term Unallocated	-	-	-	1.50	[ICRA]A- (Positive)/A2+

Source: Duroflex Private Limited

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

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