

February 06, 2020

Polynova Industries Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Cash Credit/Working capital demand loan	25.00	30.00	[ICRA]A-(Stable); reaffirmed
Fund-based - Working Capital Facilities (55.00)#		(60.00)#	[ICRA]A-(Stable); reaffirmed
Non-fund Based - Letter of Credit	25.00	20.00	[ICRA]A2+; reaffirmed
Non-fund Based –Bank Guarantee	1.50	1.50	[ICRA]A2+; reaffirmed
Non-fund Based – Forward Contracts	1.20	2.10	[ICRA]A2+; reaffirmed
Non-fund Based – Buyers Credit	(12.70)##	-	[ICRA]A2+; reaffirmed
Unallocated Limits	16.80	10.00	[ICRA]A-(Stable)/[ICRA]A2+; reaffirmed
Total	69.50	63.60	

*Instrument details are provided in Annexure-1

#Sub limit within the Cash Credit limit

##Sub limit within the Letter of Credit limit

Rationale

The ratings, reaffirmed, take into account not only the extensive experience of the promoters and the key management personnel of Polynova Industries Limited (PIL or the company) but also the continued financial flexibility of the company as part of the Lupin Group [Lupin Limited (rated [ICRA]A1+)]. Moreover, the company's financial profile remains comfortable with a robust growth in revenues in FY2019, a growing accretion to reserves and, lastly, modest debt levels. The ratings continue to favourably factor in the diversified segment mix with end-user sales to the automotive and the footwear sectors in both the domestic market and the exports market along with an established customer base across these markets. With a ramp-up in sales from a few major overseas customers, exports have increased in FY2019 to 30% up from 21% in FY2018 and the same is likely to be a key revenue driver in the coming years. In brief, PIL remains one of the few organised players in the domestic artificial leather industry.

The ratings are, however, constrained by the subdued revenue performance in one of its key segments, the footwear sector, dampened by lower demand growth while facing higher competition. Moreover, surplus capacity in the synthetic leather industry has led to significant pricing pressure for the company and declining revenues from the footwear segment. In the automobile sector, sales is also likely to be low in the current fiscal, given the ongoing slowdown in the two-wheeler sales, as well as that in other vehicles. Besides, the fluctuations in raw material prices owing to movement in crude oil prices and PIL's susceptibility to the regulatory risk of anti-dumping duty - puts upward pressure on its input costs. Volatile input cost makes it difficult to pass on the same to its customers, especially to the less price flexible original equipment manufacturers (OEMs) with significant bargaining power. Exports remain vulnerable to foreign exchange fluctuations, though partly hedged by the import of raw materials. ICRA also notes the relatively high working capital intensive nature of operations – as indicated by NWC/OI of 27% as on March 31, 2019 –ensuing from stretched receivables and high inventory holding.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that PIL will continue to benefit from the extensive domain experience of its promoters, as well as their support, and will follow a prudent financial policy characterised by low leverage and adequate liquidity.

Key rating drivers and their description

Credit strengths

Strong financial flexibility as part of the Lupin Group – PIL was incorporated in 1986 by the promoters of Lupin Limited for manufacturing coated technical fabrics, also known as artificial/synthetic leather. ICRA takes significant comfort from the company's parentage and their demonstrated track record of supporting PIL in times of strife through extending unsecured loans. The promoters' commitment was further reiterated in FY2016 when unsecured loans were converted into equity, strengthening its capital structure.

Diversified segment mix with end-user sales to automotive and footwear sectors; favourable exports growth prospects – The Polyvinyl Chloride (PVC) coated fabrics find application in the automotive, upholstery, furnishings, fashion (for bags) and footwear industries. The company also caters to the international market with major sales to the U.S.A. (~50% of exports) followed by Europe (~25%) and, the balance, to the Middle East and other countries. In FY2019, export sales accounted for 30% of the total sales, and was the year's key revenue driver, given additional export orders received.

Repeat orders from an established clientele in the domestic and export markets – The footwear and automotive (two-wheeler and four-wheeler segments) sectors are the major revenue generating sources of PIL. In the automotive segment, the company caters to reputed OEMs such as TVS, Hyundai, Toyota, Hero Moto Corp and others through tier-1 suppliers. In the footwear segment, it supplies to shoe manufacturers like Paragon Footwear and VKC directly. Although the customer concentration risk has remained high with the top three customers accounting for ~45% of the total sales in FY2019, its long-term association with these established customers provides comfort.

One of the few organised companies in the synthetic leather industry not counting the market leader Mayur Uniquoters – Intense fragmentation due to low entry barriers has led to stiff competition in the synthetic leather industry. Nevertheless, the organised players have an advantage with the increasing demand from the automotive and other emerging segments for quality products such as furnishing. PIL is one of the few organised players in the domestic artificial leather industry, and is supported by an experienced management.

Strong performance in most financial parameters boosting financial profile – PIL's financial profile continues to remain comfortable, as demonstrated by a robust growth in revenues of 29% in FY2019, and a strong net worth base of Rs. 79.48 crore as on March 31, 2019. In FY2019, with a decline in the working capital borrowings, its capital structure continued to look up with a gearing of 0.23 times as on March 31, 2019. The debt coverage metrics (interest coverage of 11.94 times) as on March 31, 2019 continued to be strong backed by an increase in operating profit levels.

Credit challenges

Slowdown in sales from low sectoral demand; increased pricing pressure and lower domestic revenues – Intense competition and extended replacement cycles in the domestic footwear industry restricting room for further growth. As far as the domestic footwear sector is concerned, PIL's sales has slowed down in the past owing to intense competition as well as implementation of policies such as demonetisation and Goods and Services Tax (GST). In the current fiscal,

sales to the automobile sector is also likely to slow down given the ongoing weakness in two-wheeler sales, as well that in other vehicles, due to overall loss of momentum in economic activity.

Moderate operating and net margins due to commoditised nature of business - The commoditised nature of the products led to moderate profitability. PIL's operating margins were impacted in the past because of slowdown due to one-time events such as demonetisation and GST implementation leading to low sales realisation. Further, pricing pressure – due to stiff competition in the footwear sector coupled with under absorption of overhead costs and increase in raw material prices – has dampened the operating profit margins in FY2017 and FY2018. ICRA ratings, nevertheless, take comfort from the increasing proportion of the company's export sales, which has driven its revenue growth and marginal upturn in profitability in FY2019.

Vulnerability to forex fluctuations and raw material prices; contract pricing restricts pricing flexibility – Contract pricing with the major OEMs in India – that serve as PIL's customers – restricts its pricing flexibility and exerts pressure on its profit margins. The company is especially vulnerable since its major raw materials consist of polymers, resins, and polyester fabrics that are sensitive to crude oil prices. Exports remain vulnerable to foreign exchange fluctuations, though they are partly hedged by the import of raw materials.

Working capital intensive nature of operations, although reliance on working capital facilities remains low – PIL's working capital intensity (depicted by NWC/OI) continues to remain moderately high at 27% as on March 31, 2019, due to long receivables cycle as well as the high cost of inventory holding. The company has three factories and has to keep adequate raw material stocks of release paper in each factory, and other key raw materials, which pushes the inventory cycle up. The credit period offered to customers also gets stretched owing to the slow demand conditions. Nonetheless, a decline in the working capital intensity as on March 31, 2019 to 27% over 32% as on March 31, 2018, owing to faster movement of sales and collection of receivables, as well as low reliance on working capital limits, provides some comfort.

Liquidity position: Adequate

The cash flow from operations has been positive in the last five financial years on account of a gradual improvement in profitability and moderate working capital requirement. This is also reflected in its moderate average utilisation of ~46% of the sanctioned working capital limits in the past 15 months. Given PIL's modest capital expenditure requirement in the near term, unutilised lines of credit of ~Rs. 38 crore and a comfortable profitability, it's expected that liquidity will remain adequate.

Rating sensitivities

Positive triggers – ICRA could upgrade PIL's rating if there is substantial growth in revenue and profitability, and better working capital management, strengthening the liquidity profile. Strengthening of net worth base will also remain critical for a rating upgrade.

Negative triggers – Negative pressure on PIL's rating could arise if revenues and profitability are lower than expected, with higher receivables and inventory levels stretching the working capital cycle and weakening liquidity.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Indian Textile Industry-Fabric
Parent/Group Support	N.A.
Consolidation / Standalone	Standalone - The ratings are based on the standalone financial profile of the

company

About the company

Incorporated in 1986, PIL is a leading manufacturer and exporter of coated fabrics in India. It is closely held by the promoters of Lupin Limited. The company manufactures coated technical fabrics, also known as artificial or synthetic leather. The primary applications of coated fabrics are in the automotive, footwear, furnishings, general stationery and upholstery industries. PIL is a major player in the automotive segment, supplying to ancillaries (tier-I suppliers) appointed by the automotive OEMs. The coated fabrics manufactured for automotive players are used in seat covers, door plan, dashboard, roof lining and for providing insulation between engine and passenger compartments. PIL also supplies to shoe manufacturers.

The company has three manufacturing units located at Goa and Gujarat. Post commercialisation of its third coating line at its manufacturing plant in Goa, its capacity now stands at approximately 184 lakh linear metre per annum. For FY2018, the domestic market contributed to around 79% of the total sales with the rest being led by exports, primarily to Europe and North America.

In FY2019, the company reported a net profit of Rs. 12.14 crore on an operating income (OI) of Rs. 249.21 crore, as compared to a net profit of Rs. 6.98 crore on an OI of Rs. 193.04 crore in the previous year. For H1 FY2020, on a provisional basis, PIL reported a net profit of Rs. 5.85 crore on an operating income (OI) of Rs. 124.74 crore

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	6M FY2020 (Unaudited)
Operating Income (Rs. crore)	193.04	249.21	124.74
PAT (Rs. crore)	6.98	12.14	5.85
OPBDIT/OI (%)	7.59%	8.82%	8.95%
RoCE (%)	13.45%	19.35%	18.25%
Total Outside Liabilities/Tangible Net Worth (times)	0.67	0.57	0.55
Total Debt/OPBDIT (times)	1.65	0.84	0.64
Interest Coverage (times)	9.26	11.94	14.04
DSCR	7.07	9.33	11.06

Source: Financial statements of PIL and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for the last three years:

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					6-Feb-20	27-Dec-18	22-Dec-17	29-Nov-16
1	Cash Credit/Working Capital Demand Loan	Long- Term	30.00	-	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)
2	Export Packing Credit/ Export Bill Discounting/ E-vendor finance facility	Short-Term	(60.00) #	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
3	Letter of Credit	Short-Term	20.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
4	Bank Guarantee	Short-Term	1.50	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
5	Forward contracts	Short-Term	2.10	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
6	Unallocated Limits	Long-term & Short-term	10.00	-	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]BBB+(Stable)/ [ICRA]A2+

Sub limit within the Cash Credit limit

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
NA	Cash Credit/Working Capital Demand Loan	NA	NA	NA	30.00	[ICRA]A- (Stable)
NA	Export Packing Credit/ Export Bill Discounting/ E-vendor finance facility	NA	NA	NA	(60.00)	[ICRA]A2+
NA	Letter of Credit	NA	NA	NA	20.00	[ICRA]A2+
NA	Bank Guarantee	NA	NA	NA	1.50	[ICRA]A2+
NA	Forward contracts	NA	NA	NA	2.10	[ICRA]A2+
NA	Unallocated Limits	NA	NA	NA	10.00	[ICRA]A-(Stable)/ [ICRA]A2+

Sub limit within the Cash Credit limit

Source: Polynova Industries Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
N.A.	N.A.	N.A.

ANALYST CONTACTS

K Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Suprio Banerjee

+91 22 6114 3443

supriob@icraindia.com

Rupa Pandey

+91 22 6114 3456

rupa.pandey@icraindia.com

Nijara Kalita

+91 22 6114 3455

nijara.kalita@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2020 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents