

February 07, 2020

Sri Shanmugavel Mills Private Limited: Ratings downgraded to [ICRA]A@[ICRA]A2+@; ratings remain on watch with negative implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based- Working Capital Facilities	125.00	125.00	[ICRA]A@; rating downgraded from [ICRA]A+@, remains on watch with negative implications
Non-fund based-Working Capital Facilities	60.00	60.00	[ICRA]A2+@; rating downgraded from [ICRA]A1@ ,remains on watch with negative implications
Unallocated limits	60.00	60.00	[ICRA]A@[ICRA]A2+@; ratings downgraded from [ICRA]A+@[ICRA]A1@ , remain on watch with negative implications
Total	245.00	245.00	

*Instrument details are provided in Annexure-1

Rationale

For arriving at the rating, ICRA has taken a consolidated view of the eight companies in the SSM Group¹ given the strong operational linkages among these companies rated and their common management. The revision in ratings reflects the weaker-than expected performance of the SSM Group in the current fiscal on the back of demand slowdown in the cotton spinning industry and its consequent impact on the Group's earnings. While revenues have been stagnant, the operating profits have declined by around 30% in 9M FY2020 (operating margins are lower by around 300 bps at ~7%). The same is in line with the industry, with yarn prices registering a higher decline than the cotton prices (adjusted for the inventory held). The Group's revenues have been steady, supported by its strong customer base, despite tepid demand conditions faced by the sector with yarn exports from India contracting by more than 35% YoY in the period April to November 2019. While revenues are likely to remain flat in FY2020, the Group's long relationship with a reputed clientele across domestic and export markets is likely to support revenue growth of around 6-8% over the medium term. Operating margins are also likely to recover to around 8% in the coming quarters, albeit to levels lower than the 10% seen in FY2019, supported by some recovery in contribution levels. The lower-than anticipated earnings from operations, coupled with an increase in working-capital debt levels witnessed in YTD FY2020 are expected to moderate the Group's leverage indicators and free cash flows. Its

¹ The eight companies rated and collectively referred to as the SSM Group include: (a) Sri Shanmugavel Mills Private Limited, (b) Sudhan Spinning Mills Private Limited, (c) Sivaraj Spinning Mills Private Limited, (d) Adisankara Spinning Mills Private Limited, (e) Sri Velayudhaswamy Spinning Mills Private Limited, (f) Prabhu Spinning Mills Private Limited, (g) Vedha Spinning Mills Private Limited, and (h) Sri Matha Spinning Mills Private Limited

adjusted debt² to operating profit is expected to increase to more than 2.5 times in FY2020 (from 1.5 times in FY2019) and subsequently improve to ~2.25 times in FY2021. Nevertheless, its coverage metrics remain at adequate levels, with interest coverage and debt service coverage ratios (DSCR) likely to be at around 4.5 times and 2.25 times, respectively in FY2020. Further, the said coverage ratios are likely to improve to around 5 times and 2.5 times, respectively in FY2021, supported by the expected better earnings and lower working capital intensity. The same is despite the proposed expansion plans of the Group, of around Rs. 300 crore cumulative over the period FY2020 to FY2022. The ratings remain supported by the established market presence of the SSM Group and its strong operational profile, with an integrated presence across the value chain and favourable economies of scale enabled by its position as one of the largest cotton spinners in South India. The ratings also continue to factor in the relatively low operating profitability (owing to the Group's limited value addition with high dependence on low value-added coarser and medium counts) and the inherently competitive nature of the industry, restricting pricing power. The SSM Group has extended financial support (in the form of loans and advances) to some of the other companies owned by the promoter family, which stood at Rs. 60 crore as on March 31, 2019 (increased from Rs. 30 crore in the preceding fiscal). ICRA expects the Group's support to these entities to be restricted at the current levels, going forward.

The ratings remain on watch with negative implications because of the uncertainties over the existing operational linkages among the companies, upon completion of the ongoing business restructuring exercise within the Group. Further, ICRA notes that the financial linkages between the companies have been limited in the recent past. The existing operational synergies include a centralised purchase and order sourcing arrangement to leverage on the brand strength of the flagship companies and command better bargaining power with suppliers. Any change in the existing *modus operandi* because of the proposed restructuring remains to be seen. ICRA will continue to monitor developments in this regard and evaluate the impact of the restructuring on the companies' business performance once the final structure evolves. ICRA understands that this exercise, which was earlier expected to be completed by December 2017, is now likely to be completed by September 2020. There has been a delay in filing of the draft scheme of arrangement with the National Company Law Tribunal (NCLT), which is expected to be done by March 2020. This exercise is being undertaken by the promoter directors to hand over the ownership and management control of the eight companies to the next generation. As a part of the arrangement, the existing assets and liabilities of the eight companies are proposed to be reallocated among them in varying proportions.

Key rating drivers and their description

Credit strengths

Established presence in the medium and coarser count hosiery yarn market – The SSM Group is among the largest textile groups in South India, with an installed capacity of around 5 lakh spindles, along with sizeable capacities in the fabric segments. The Group is the leading supplier of medium and coarser count hosiery yarn market in Tamil Nadu (which includes the large hosiery hub in Tirupur), apart from enjoying an established presence across other key domestic and export markets.

Strong operational profile lends some stability to revenues and earnings – The SSM Group enjoys an integrated presence across ring spun and open-ended yarn, knitted fabric and woven fabric segments, lending business

² considering average utilisation of working-capital debt during the fiscal as against peak debt utilised at the end of the fiscal in March

diversification and improved economies of scale. The Group's revenues are also diversified across domestic and export markets, buffering the impact of slowdown in any one segment. The Group has captive wind capacity of 175 MW, which caters to more than 80% of its power requirements, lending considerable costs savings. These strengths have helped the Group support its volumes and earnings to some extent in FY2018 and in the current fiscal, amid challenging demand conditions.

Comfortable debt protection metrics – Despite a drop in earnings and increase in debt levels in the current fiscal, the SSM Group's coverage metrics have remained comfortable. Key ratios like DSCR and interest coverage ratio were at around 2.5 times and 4.5 times, respectively for 9M FY2020, driven by the Group's stable accruals and limited dependence on external debt over the years.

Credit challenges

Modest demand and unfavourable input costs to adversely impact performance in FY2020 – Weaker-than-expected export demand since Q3 FY2019 has adversely impacted contribution levels for spinners, with earnings coming under severe pressure, especially in Q2 FY2020. The impact on the overall performance for the fiscal is likely to be buffered to some extent by the steady earnings from its windmills and some improvement in contribution levels witnessed in the recent months.

Moderate operating profitability – The SSM Group's operating margins have been constrained over the years owing to limited value addition, with concentration on the coarser and medium counts in the spinning segment. Also, earnings from the woven fabric, home textile and garment segments have been weak, adversely impacting its overall margins. Further, its earnings remain exposed to volatile raw material prices as seen in the current fiscal, owing to the highly competitive and commoditised spinning industry, which restricts pricing flexibility.

Any potential impact of the restructuring exercise a key rating factor – The operational and financial performances of the Group over the years have been supported by strong linkages among the Group companies, lending scale and synergy benefits and considerable financial flexibility in the form of inter-corporate loans. Post the restructuring, any change in the current arrangements leading to the eight individual companies operating independently, would reduce synergy benefits and adversely impact their performance.

Liquidity position: Adequate

The SSM Group's liquidity position has remained adequate in the recent quarters, supported by its earnings from operations and adequate unutilised lines of credit. Despite the moderation in performance in the current fiscal, the Group had unutilised lines of credit of around Rs. 225 crore at the end of December 2019, which is likely to reduce to around Rs. 100 crore at the end of March 2020 because of funds to be utilised towards cotton procurement in Q4 FY2020. The average utilisation of its fund-based limits is expected to increase to around 65% in FY2020 (from around 55% levels in the last two fiscals). Despite the proposed capital expenditure, the expected growth in earnings in the coming quarters, low repayment obligations and adequate unutilised lines of credit are likely to support the liquidity position of the SSM Group.

Rating sensitivities

Positive triggers – As the ratings remain on watch with negative implications, an upgrade in ratings is unlikely in the coming quarters till the scheme of arrangement is finalised and some clarity emerges on the likely impact of the said restructuring on the credit profile of the Group.

Negative triggers – ICRA may downgrade the ratings, if the SSM Group’s operating performance is weaker than expected or because of any further elongation of its working capital cycle, which would adversely impact its credit metrics. Downward rating pressure may arise: if 1) its adjusted debt to operating profits increase to more than 2.5 times on a sustained basis and 2) its coverage metrics including DSCR and interest coverage ratio reduce to less than 2 times and 4 times, respectively on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Spinning Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	Based on the consolidated financial statements of the eight companies in the SSM Group, details of which are provided in Annexure II

About the company

Sri Shanmugavel Mills Private Limited (SSMPL), the flagship company of the SSM Group, was set up in 1980 with an installed capacity of 24,640 spindles. In FY2006, Shanmugavel diversified into weaving. At present, it has two facilities, manufacturing knitted yarn and grey fabric. The former has an installed capacity of 48,336 spindles, while the weaving division has a capacity of 240 looms. The spinning division of Shanmugavel produces counts ranging from 28s to 50s (with average counts of 30s+ being produced). A bulk of the yarn manufactured by the company finds its application in the knitting fabric segment. Shanmugavel acts as one of the aggregators of export orders for the Group, given its established presence across various export markets. Over the years, the company has also invested in windmills and has an installed capacity of 23.7 MW, used primarily for captive consumption. The company has also ventured into manufacturing of home textiles in the recent past for product diversification and forward integration, where the ring spun yarn from spinning is converted into woven fabric in its weaving division.

SSM Group profile

Founded in 1981 by Late S. Chennimalai Gounder, the SSM Group is one of the largest textile groups in South India with interests in cotton yarn, knitted fabric and woven fabric. While the operations of the Group were initiated with establishing Sri Shanmugavel Mills (P) Limited in 1981 with an installed capacity of 24,640 spindles, over the years, the Group has expanded its operations and diversified into manufacturing and sale of products such as combed cotton yarn, compact yarn, OE yarn, knitted fabric, and woven fabric. As of March 31, 2019, the Group has an installed capacity of around 5 lakh spindles, 10,400 rotors, 240 looms and 400 knitting machines, manufacturing products across the textile value chain. The Group also has 230 windmills with a capacity to generate 176.25 MW power.

Key financial indicators (Consolidated and audited)

	FY2018	FY2019
Operating Income (Rs. crore)	3,096.5	3,423.9
PAT (Rs. crore)	135.0	168.1
OPBDIT/OI (%)	8.4%	10.1%
RoCE (%)	9.8%	12.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.7
Total Debt/OPBDITA (times)	2.6	2.3
Interest Coverage (times)	6.4	6.7
DSCR	5.0	4.1

Source: SSMPPL and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Rating (FY2020)				Rating History for the Past 3 Years			
	Type	Amount Rated	Amount Outstanding	Current Rating Feb 7, 2020	Earlier Rating Jun 5, 2019	FY2019 Mar 29, 2018	FY2018 Jun 1, 2017	FY2017 Jan 12, 2017	
1	Fund based- Working Capital Facilities	125.00	-	[ICRA]A@	[ICRA]A+@	[ICRA]A+&	[ICRA]A+&	[ICRA]A+ (stable)	
2	Non-fund based-Working Capital Facilities	60.00	-	[ICRA]A2+@	[ICRA]A1@	[ICRA]A1&	[ICRA]A1&	[ICRA]A1	
3	Unallocated limits	60.00	-	[ICRA]A@/ [ICRA]A2+@	[ICRA]A+@/ [ICRA]A1@	[ICRA]A+& / [ICRA]A1&	[ICRA]A+& / [ICRA]A1&	[ICRA]A+ (stable) / [ICRA]A1	

Amount in Rs. crore; Source: SSMPPL

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	-	-	-	125.00	[ICRA]A@
NA	Letter of credit	-	-	-	60.00	[ICRA]A2+@
NA	Unallocated limits	-	-	-	60.00	[ICRA]A@/ [ICRA]A2+@

Source: SSMPPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Sudhan Spinning Mills Private Limited	-	Full Consolidation
Sivaraj Spinning Mills Private Limited	-	Full Consolidation
Sri Velayudhaswamy Spinning Mills Private Limited	-	Full Consolidation
Prabhu Spinning Mills Private Limited	-	Full Consolidation
Adisankara Spinning Mills Private Limited	-	Full Consolidation
Vedha Spinning Mills Private Limited	-	Full Consolidation
Sri Matha Spinning Mills Private Limited	-	Full Consolidation

Note: The above companies are consolidated with SSMPL because of the strong operational linkages and common management *Source: SSMPL*

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