

September 28, 2020

## Sri Shanmugavel Mills Private Limited: Ratings downgraded to [ICRA]BBB+/[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- Term Loans	0.00	9.00	[ICRA]BBB+@; downgraded from [ICRA]A-@ and remains on watch with negative implications
Fund based- Working Capital Facilities	125.00	100.00	[ICRA]BBB+@; downgraded from [ICRA]A-@ and remains on watch with negative implications
Non-fund based-Working Capital Facilities	60.00	30.00	[ICRA]A2@; downgraded from [ICRA]A2+@ and remains on watch with negative implications
Unallocated limits	60.00	106.00	[ICRA]BBB+@ downgraded from [ICRA]A-@; [ICRA]A2@ downgraded from [ICRA]A2+@; ratings remain on watch with negative implications
<b>Total</b>	<b>245.00</b>	<b>245.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating action primarily factors in the change in the analytical approach for arriving at the ratings of Sri Shanmugavel Mills Private Limited (SSMPL) from considering a consolidated view of the eight companies in the SSM Group<sup>1</sup> earlier to a standalone approach. While the SSM Group's common credit profile was considered earlier owing to the strong operational and financial linkages among the eight companies along with a common management, the ongoing business restructuring exercise within the Group has constrained the linkages in the recent past. There are no financial linkages at present among the companies, with the day-to-day operations of the individual companies now being managed by the prospective owners. While some of the individual companies in the Group had benefited from a shared credit profile in the past, with companies having stronger balance sheets and healthy liquidity position supporting other entities, the financial flexibility has weakened in the recent past. This has resulted in the individual companies' dependence on external funding to meet their capital expenditure and working capital requirements. SSMPL's ratings reflect its standalone operational strengths and credit metrics, which are expected to witness some deterioration in the current fiscal largely because of a fall in earnings from operations. The continued pressure on operating performance witnessed in H1 FY2021 following the adverse

<sup>1</sup> 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

impact on demand conditions in the cotton spinning industry because of the Covid-19 pandemic is likely to result in a moderation in earnings and consequently credit metrics in the current fiscal.

The ratings remain on watch with negative implications because of uncertainties related to the impact of the business restructuring on the credit profile of the company. As a part of the proposed scheme of arrangement, the existing assets and liabilities of the SSM Group companies are to be reallocated among them in varying proportions. While operational synergies including a centralised purchase and order sourcing arrangement continue at present, the degree of operational linkages among the companies upon completion of the restructuring exercise remains to be seen. ICRA will continue to monitor developments and evaluate the impact of the restructuring on SVJSMPL's credit profile once the final structure evolves. ICRA understands that this exercise is likely to be completed by June 2021, with the filing of the draft scheme of arrangement with the National Company Law Tribunal (NCLT) expected to be done by November 2020. This exercise is being undertaken by the promoter directors to hand over the ownership of the eight companies to the next generation.

While SSMPL's revenues declined by around 15% in FY2020, because of weak demand conditions, the operating margins were stable at around 6%. While most of the spinners had witnessed lower earnings in FY2020 with yarn prices falling more than the cotton prices (adjusted for the inventory held), SSMPL's margins were supported by an improvement in profitability of its weaving division. Its revenues were supported by the strong customer base of the SSM Group despite tepid demand conditions in the sector with yarn exports from India contracting by more than 30% in FY2020. Stable earnings and an improvement in its working capital cycle had supported its credit metrics in FY2020, with the total debt to operating profits and interest coverage improving to around 2.5 times and 7.0 times, respectively in the fiscal. However, earnings are expected to moderate in the current fiscal owing to the impact of the lockdown and weak offtake from customers across markets during the first four months of the fiscal following the Covid-19 pandemic. The improvement in demand conditions witnessed in recent months for the knitted yarn segment is likely to limit the impact of the pandemic-induced stress on volumes and earnings to an extent. Overall, revenues are likely to decline by around 15% in the fiscal, with the operating margins likely to moderate to around 4% in FY2021. This pressure on earnings from operations is likely to moderate the company's credit metrics in FY2021. Key ratios including total debt to operating profits and interest coverage are likely to be at around 4.5 times and 3 times, respectively in FY2021. The short-term debt levels at its peak at the end of the fiscal, in line with the cotton stocking requirements. Adjusting the same considering the average utilisation levels during the fiscal, the total debt to operating profits is expected to be at around 4 times in FY2021. Further, SSMPL's credit metrics are expected to improve in FY2022, with a steady growth in earnings and limited capital expenditure funding requirements expected (adjusted debt to operating profits and interest coverage ratios estimated to improve to around 2.75 times and 4.5 times, respectively in the next fiscal). Despite lower earnings and weakening of coverage metrics in the current fiscal, SSMPL's liquidity position remains adequate, which is expected to aid in meeting its near-term funding requirements. The ratings factor in the operational synergies enjoyed by SSMPL for being a part of the large SSM Group, one of the largest cotton spinners in South India, which has an established market presence in the knitted yarn market. SSMPL's earnings and credit metrics are constrained by its low operating profitability (because of limited value addition with high dependence on low value-added medium counts), and the inherently competitive nature of the industry, restricting its pricing power.

## Key rating drivers and their description

### Credit strengths

**Established presence in the hosiery yarn market** – The SSM Group is among the largest textile groups in South India, with an installed capacity of around 5.5 lakh spindles, along with sizeable capacities in the fabric segment. With the cotton procurement and order sourcing continuing to be centralised at present, SSMPL enjoys scale and synergy benefits from operationally being a part of a large group. SSMPL also benefits from its diversified presence across spinning and weaving, with the improvement in profitability of its weaving segment supporting the overall performance in FY2020. The SSM 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.

**Conservative capital structure** – Supported by relatively steady earnings and diversified business presence with limited reliance on external debt, SSMPL's capital structure and coverage metrics have remained at adequate levels. Its gearing and interest coverage ratio stood at 0.4 times and 7 times, respectively in FY2020, further backed by its adequate unutilised lines of credit.

## Credit challenges

**Performance expected to remain under pressure in H1 FY2021** – Weaker-than-expected export demand adversely impacted volumes and contribution levels for spinners in FY2020. The overall impact on the company's performance was buffered by the steady profits from its weaving division. In line with the industry, SSMPL's revenues and earnings are expected to be adversely impacted in FY2021, owing to tepid demand conditions witnessed following the worldwide Covid-19 pandemic and weak contribution levels expected during the major portion of H1 FY2021. This would result in a deterioration of credit metrics to moderate levels for the fiscal.

**Moderate operating profitability** – SSMPL's operating margins and return indicators have been constrained owing to limited value addition, with concentration on medium counts in the spinning segment. Also, losses incurred in the home textiles segment adversely impacted its overall margins over the years (except in FY2020 when operations were scaled down to reduce losses). Further, its earnings remain exposed to volatile raw material prices, as seen in the current fiscal, owing to the intensely competitive and commoditised spinning industry, which restricts its pricing flexibility.

## Liquidity position: Adequate

SSMPL's liquidity position remains adequate, supported by its unutilised lines of credit. Despite thin earnings from operations in 5M FY2021, the company had unutilised lines of credit of around Rs. 57 crore at the end of August 2020. The average utilisation of its fund-based limits stood at around 42% in FY2020 and 50% in 5M FY2021. Despite the likely pressure on fund flow from operations in H2 FY2021 to finance its working capital requirements (to fund procurement of cotton), adequate unutilised lines of credit are expected to support SSMPL's liquidity position.

## Rating sensitivities

**Positive triggers** – As the ratings remain on watch with negative implications on the back of the ongoing business restructuring, 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 company.

**Negative triggers** – ICRA may downgrade the ratings if there is a sustained pressure on the company's operating performance or because of any elongation of its working capital cycle, which would adversely impact its credit

metrics and liquidity position. Specific credit metrics which may result in a downgrade include Total Debt/OPBITDA exceeding 2.75 times and DSCR remaining below 1.5 times on a sustained basis. SSMPL's ratings may also be downgraded in case of any adverse impact on the company's credit profile upon completion of the restructuring exercise.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Spinning Companies</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

## 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, SSMPL diversified into weaving. At present, it has two facilities, which manufacture 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 SSMPL produces counts ranging from 28s to 50s (with average counts of 30s+ being produced). A bulk portion of the yarn manufactured by the company finds its application in the knitting fabric segment. Over the years, the company has also invested in windmills and has an installed capacity of 23.7 MW, used primarily for captive consumption.

## Key financial indicators

	FY2019	FY2020
Operating Income (Rs. crore)	621.14	521.07
PAT (Rs. crore)	16.29	13.25
OPBDIT/OI (%)	5.28%	5.96%
PAT/OI (%)	2.62%	2.54%
Total Outside Liabilities/Tangible Net Worth (times)	0.86	0.64
Total Debt/OPBDITA (times)	3.07	2.48
Interest Coverage (times)	4.52	7.42

Source: SSMPL and ICRA research; FY2020 figures are provisional

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

		Rating (FY2021)				Rating History for the Past 3 Years				
	Type	Amount Rated	Amount Outstanding	Current Rating		FY2020		FY2019	FY2018	
				Sep 28, 2020	May 4, 2020	Feb 7, 2020	Jun 5, 2019	Mar 29, 2018	Jun 1, 2017	
1	Fund based- Term Loans	Long Term	9.00	9.00	[ICRA]BBB+@	-	-	-	-	
2	Fund based- Working Capital Facilities	Long Term	100.00	-	[ICRA]BBB+@	[ICRA]A-@	[ICRA]A@	[ICRA]A+@	[ICRA]A+&	
3	Non-fund based- Working Capital Facilities	Short Term	30.00	-	[ICRA]A2@	[ICRA]A2+@	[ICRA]A2+@	[ICRA]A1@	[ICRA]A1&	
4	Unallocated limits	Long Term/ Short Term	106.00	-	[ICRA]BBB+@/ [ICRA]A2@	[ICRA]A-@/ [ICRA]A2+@	[ICRA]A@/ [ICRA]A2+@	[ICRA]A+@/ [ICRA]A1@	[ICRA]A+& / [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](http://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	Term Loans	July 2020	-	June 2022	9.00	[ICRA]BBB+@
NA	Cash credit	-	-	-	100.00	[ICRA]BBB+@
NA	Letter of credit	-	-	-	30.00	[ICRA]A2@
NA	Unallocated limits	-	-	-	106.00	[ICRA]BBB+@/ [ICRA]A2@

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Source: SSMPL

**Annexure-2: List of entities considered for consolidated analysis: NA**

## ANALYST CONTACTS

**Jayanta Roy**

+91 33 7150 1120

[jayanta@icraindia.com](mailto:jayanta@icraindia.com)

**Balaji M**

+91 44 4596 4317

[balajim@icraindia.com](mailto:balajim@icraindia.com)

**Subholakshmi Bose**

+91 80 4332 6403

[subholakshmi.bose@icraindia.com](mailto:subholakshmi.bose@icraindia.com)

## RELATIONSHIP CONTACT

**Jayanta Chatterjee**

+91 80 4332 6401

[jayantac@icraindia.com](mailto:jayantac@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

### Helpline for business queries:

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

[info@icraindia.com](mailto:info@icraindia.com)

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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.

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## 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](mailto:info@icraindia.com)

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

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