Eurotex Industries and Exports Limited

November 23, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based - Term Loan	1.88	1.88	[ICRA]B+, downgraded from [ICRA]BB-; Outlook revised to Stable from Negative
Fund Based –CC/EPC	49.50	49.50	[ICRA]B+, downgraded from [ICRA]BB-; Outlook revised to Stable from Negative
Non -Fund Based –LC/BG/ Credit Exposure Limit/ Forex Treasury Limit	11.00	11.00	[ICRA]A4; reaffirmed
Unallocated Limits	21.62	21.62	[ICRA]B+/[ICRA]A4; downgraded from [ICRA]BB-/ [ICRA]A4; Outlook revised to Stable from
Total	**84.00**	**84.00**	-

*Instrument details are provided in Annexure-1

Material Event

Eurotex Industries and Exports Limited ('Eurotex' or 'the company')[1] has announced its quarterly results on November 14, 2018. The company reported an operating income of Rs. 120.65 crore[2] with operating loss of Rs. 1.52 crore and net loss of Rs. 6.87 crore in H1FY2019 against operating income of Rs. 114.41 crore with operating loss of Rs. 4.08 crore and net loss of Rs 8.85 crore in H1FY2018.

Impact of the Material Event

ICRA has revised the long-term rating to [ICRA]B+ (pronounced ICRA B plus) from [ICRA]BB- (pronounced ICRA double B minus) and has reaffirmed the short-term rating at [ICRA]A4 (pronounced ICRA A four) assigned to the Rs. 84.00 crore bank facilities of Eurotex. The outlook on the long-term rating has been revised to Stable from Negative.

Persisting high cost of production has exerted pressure on the operating performance and the same continues to remain weak. Although the company has reported a YoY growth in revenues of ~5% in H1FY2019, continued operating and net losses have led to a deterioration in the financial profile.

Rationale

The revision in rating factors in the sustained weakness in the company's operating performance in H1 FY2019, owing to higher cost of production, mainly power and labour along with high raw material cost, which has continued to impact the financial profile adversely, with operating losses in H12019. Besides, the power subsidy of Rs. 2 per unit offered in the Maharashtra State Textile Policy 2018-23, which was expected to provide some respite on the power costs front is still due, exerting pressure on the profitability. The ratings continue to be constrained by the deteriorating capital structure, stretched debt coverage indicators and commodity price risk posed by the holding of high raw material inventory (as indicated by inventory days of 86 days as on September 30, 2018). Further, regulatory risks in the form of changing

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[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.*

[2] *Rs. 100 lakh = Rs. 1 crore = Rs. 10 million*

Government policies with respect to export of cotton and cotton yarn are other rating concerns. ICRA also notes the recent labour unrest in its factory which has affected the production. Faster resolution of labour issues along with proposed receipt of power subsidy remains critical for any meaningful recovery in the company's operating performance.

The ratings, however, continue to favourably factor in the established experience of the promoters in the textile industry, and the well-established position of the company as a cotton yarn exporter with a geographically diverse customer base.

Outlook: Stable

ICRA believes Eurotex will continue to benefit from the extensive experience of its promoters as well as its established presence in yarn manufacturing business. The outlook may be revised to Positive if the company is able to bring in requisite funds to support its liquidity profile and turn around its operations through better cost management. The outlook may be revised to Negative, if continued losses incurred further exerts pressure on the liquidity profile.

Key rating drivers

Credit strengths

Vast experience of the promoters in the textile industry, mainly in spinning and exports of cotton yarn – Incorporated in 1987, Eurotex is a spinning unit with an installed capacity of 61,632 spindles, 51 Two for one Twisters (TFOs) and 24 circular knitting machines. Eurotex was promoted by the Patodia Group, founded by Shri B. L. Patodia. The Patodia Group has over 65 years of experience in the textile industry, which has helped the company in establishing its position in the industry.

Established player as a cotton yarn exporter with a well-established export network; geographically diverse customer base - Eurotex is an exporter of 100% cotton yarn. The company is also engaged in trading cotton yarn in export markets. Cotton yarn accounts for ~90% of its total sales. Exports accounted for ~86% and ~53% of total sales in FY2017 and 9M FY2018, respectively. The company has a well-established and geographically diverse export network, with Korea, Guatemala, Germany, Egypt, and Bangladesh being its major export markets.

Credit challenges

Continued weak operating performance owing to higher cost of production impacting competitiveness - Eurotex's operating income as well as profitability has been impacted by the continuous decline in cotton yarn prices and subdued volumes owing to weak global demand in FY2017 and FY2018. In H1 FY2019, with improved demand from the export market, the company has been able to report a YoY revenue growth of ~5%. Nonetheless, operating losses persisted in H1 FY2019 also, following high power and fuel cost combined with higher labour expenses (which together accounts for ~20% of the total output) as well as high raw cotton prices in the domestic market resulting in high operating costs. Operating losses incurred in FY2018 and in H1 FY2019 has further strained the coverage indicators in the current year.

Erosion of networth due to continued net losses – The consistent net losses incurred by the company has eroded the net worth base, leading to a deteriorated capital structure and weak debt metrics. Gearing has increased to 1.47 time as on September 30, 2018 over 1.26 time as on March 31, 2018. The debt protection metrics weakened further as indicated by a negative debt service coverage ratio of 0.39 times as on September 30, 2018.

Working capital intensive nature of the business due to bulk purchase of cotton during the harvesting season; high raw material inventory also poses commodity price risk - Cotton yarn spinning is a working capital-intensive business on account of considerable inventory holding requirements. The company's policy is to stock inventory of raw cotton for meeting requirements till the beginning of the next cotton season, typically up to the end of October. Inventory days as on September 30, 2018 stood at 86 days.

Recent instances of labour issues in its manufacturing unit - The workers of the company's unit at Kolhapur have resorted to strike from November 3, 2018 and no operations have been carried out since then. This is likely to further exert pressure on the company's operating performance and speedy settlement of the labour issues remains a concern.

Regulatory risk in the form of changing Government policies with respect to export of cotton and cotton yarn - The company's business remains susceptible to regulatory policies of local governments (Central and state governments in India) as well as of the governments of importing countries. Any curb by the Government on cotton yarn exports, from which Eurotex gets majority of its business, could have an impact on its revenues and profitability.

The previous detailed rating rationale is available on the following link: Click here

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About ICRA Limited:

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