February 18, 2020

Lagnam Spintex Limited: Ratings assigned to enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Limit	149.06	165.60	[ICRA]BBB- (Negative); assigned/outstanding
Short-term Fund-based Limit	1.00	2.00	[ICRA]A3; assigned/outstanding
Short-term Non-fund Based Limit	1.53	5.80	[ICRA]A3; assigned/outstanding
Total	**151.59**	**173.40**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned ratings continue to be constrained by LSL's moderate scale of operations and its financial risk profile characterised by leveraged capital structure, moderate coverage indicators and high working capital intensity of operations. The ratings continue to factor in the susceptibility of LSL's profitability to cotton prices and yarn realisations, because of the seasonal nature of cotton availability, which necessitates stocking up of inventory during the harvesting season; the demand trends; the currency movements in key export markets; and the intense competition in the fragmented industry.

The ratings, however, continue to derive comfort from the significant experience of the promoters, which spans over 30 years in the spinning industry, and the company's established and reputed customer base, which ensures repeat business.

The negative outlook continues to take into account the moderation witnessed in the financial risk profile of Lagnam Spintex Limited in the current year, amid demand-side pressures for the Indian cotton yarn and ensuing shrinkage in contribution margins of the domestic spinners. This is despite the successful ramp-up achieved by LSL, with the commissioning of capacities for ring spun yarn manufacturing and a healthy volumetric growth estimated for the company for FY2020. ICRA notes that a decline in domestic cotton prices and an uptick in cotton yarn demand is expected to support profitability from November 2019 onwards. However, with sizeable debt repayment obligations for the new project loan falling due in FY2021 and onwards, the scaling up of operations whilst improving its profitability and effective management of its working capital requirements would remain critical from a credit perspective. In this context, ICRA has taken a note of recent enhancement in LSL's fund-based working capital limits, which is expected to support the company's increased working capital requirement in H2FY2020 (given the commencement of cotton procurement season), thereby helping it operate its plant optimally. Further, ICRA notes that LSL's debt servicing indicators continue to be supported by availability of fiscal incentives, which lowers its net interest burden. Notwithstanding the procedural lags witnessed in the receipt of subsidy benefits for the term debt and availability of bank finance for funding, the incentives provide comfort.

The Negative outlook on [ICRA]BBB- rating factors in the possibility of a further weakening of the cash flows and liquidity in the subsequent quarters, due to the sustained pressure on profitability and working capital cycle. The outlook may be revised to Stable if the company is able to achieve the desired operating and financial parameters, thereby easing the liquidity position of the company. The ratings may be downgraded in case of any significant deterioration in the coverage metrics, substantial increase in operating costs, elongation in cash conversion cycle.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in textile industry – LSL was promoted by Mr. D. P. Mangal and his son, Mr. Anand Mangal. Mr. D. P. Mangal has vast experience, spanning over 30 years, in the spinning industry as he was earlier associated with RSWM Ltd. as an Executive Director and with JCT Ltd. as a Chief Executive Director.

Reputed and established customer profile – The company manufactures 100% cotton yarn, which finds application in denim, home textiles and premium shirting. Over the years, LSL has established a strong relationship with its customers, facilitating continuous order flow.

Healthy scale up of operations – With the commissioning of manufacturing of its new product—ring spun yarn, the company was able to report a healthy y-o-y growth of 107% in its net sales to Rs. 73.27 crore in H1FY2020 as compared to Rs. 35.40 crore in H1FY2019.

Fiscal benefits available to textile units – The company is eligible for interest subsidies from the Central and state governments under the Technology Upgradation Fund Scheme (TUFS) and the Rajasthan Investment Promotion Scheme (RIPS), respectively. The subsidies lower the interest costs and support the company's profitability, resulting in comfortable interest coverage ratio (4.42 times in FY2019, though the same has lowered to 2.30 times in H1FY2020 with the deterioration in profitability).

Credit challenges

Leveraged capital structure and moderate debt coverage indicators – The debt-funded capex undertaken in the past coupled with high working capital requirements and deterioration in profitability has resulted in a leveraged capital structure— the gearing was at 2.81 times and TOL/ TNW was at 3.21 times as on September 30, 2019 as compared to 2.29 times and 2.55 times respectively as on March 31, 2019. The coverage indicators also remained moderate with Total Debt/OPBDITA at 10.86 times, DSCR at 1.30 times and NCA/Debt at 5% as on September 30, 2019.

High working capital intensity – The company's working capital intensity of operations is high, owing to its elongated receivable cycle and high inventory holdings due to the seasonal nature of cotton availability, which necessitates stocking up of cotton during the harvesting season. Additionally, the low credit period allowed by its suppliers also increases the overall working capital intensity. The receivables cycle had increased from 30-45 days to 60-65 days in FY2019, resulting in higher working capital intensity, as reflected by NWC/ OI of 43% in FY2019 from 27% in FY2018. The same has subsequently lowered to 26% in H1FY2020.

Intense competition – The Indian spinning industry is highly fragmented with numerous organised and unorganised players, which restricts LSL's pricing flexibility.

Liquidity position: Adequate

The company's liquidity position currently remains adequate with limited repayment of Rs. 4.26 crore in FY2020 as against projected net cash accruals of Rs. 10.73 crore (DSCR of 1.60 times for FY2020), support from enhanced working capital limits of Rs. 50.00 crore from the earlier Rs. 25.00 crore. ICRA, however, notes with the repayments ballooning from FY2021 onwards, the scaling up of operations whilst improving the profitability and effectively managing the working capital requirements would remain important from a credit perspective.

Rating sensitivities

Positive triggers –

- Significant increase in scale and profitability, leading to improvement in debt coverage indicators (interest cover more than 3.5 times on sustained basis)
- Improvement in working capital cycle

Negative triggers –

- Sub-optimal utilisation of enhanced capacity, lower-than-anticipated operating margins and net cash accruals
- Weakening of the liquidity profile; reflected in a consistently high working capital utilisation on a sustained basis and/or increase in working capital intensity of operations
- DSCR less than 1.2 times

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry–Spinning
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the rated entity.

About the company

LSL was incorporated in 2012 as a closely held private limited company, which was subsequently converted into a public limited company in 2018. It manufactures rotor-spun cotton yarn (open end yarn) in the count ranges of 7s–20s from its manufacturing facility in Bhilwara (Rajasthan). The company started its operations with 960 rotors in 2012, which has gradually been augmented to 1,920 rotors, with a current annual manufacturing capacity of 6,000 metric tonne (MT). It sells yarn to denim and home textiles manufacturers, with most of the production catering to denim manufacturers. LSL is an ISO 9001:2015 and USTERIZED-certified company.

The company has recently set up a new unit at Bhilwara (Rajasthan) for the manufacturing of ring-spun yarn. The plant became operational in July 2019 and is equipped with 25,536 spindles with a total yarn manufacturing capacity of 18.60 MT per day.

In FY2019, the company reported a net profit of Rs. 4.78 crore on an operating income of Rs. 80.42 crore compared to Rs. 4.71 crore and Rs. 84.06 crore, respectively, reported in the previous fiscal. In six months of FY2020 (April 2019 to September 2019), the firm reported an operating income of Rs. 73.38 crore and a profit after taxation of Rs. 1.32 crore (provisional financials).

Key financial indicators (audited)

	FY2018	FY2019	H1FY2020*
Operating Income (Rs. crore)	84.06	80.42	73.38
PAT (Rs. crore)	4.71	4.78	1.32
OPBDIT/OI (%)	12.80%	14.01%	9.61%
RoCE (%)	11.50%	10.16%	6.29%
Total Outside Liabilities/Tangible Net Worth (times)	2.18	2.55	3.21
Total Debt/OPBDIT (times)	4.53	10.81	10.86
Interest Coverage (times)	3.78	4.42	2.30
DSCR	1.66	1.61	1.30

**provisional financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Rating (FY2020)					Rating History for the Past 3 Years				
			Amount Rated	Amount Outstanding	Current Rating	Earlier Rating		FY2019			FY2018	
					18-Feb-2020	26-Dec-2019	26-Apr-2019	19-Nov-2018	24-Oct-2018	18-Sep-2018	13-Sep-2017	07-Sep-2017
1	Term Loan	Long Term	115.60	100.95*	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
2	Cash Credit	Long Term	50.00	-	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
3	Bank Guarantee	Short Term	3.50	-	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3
4	Standby line of credit	Short Term	2.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	-
5	Forward Cover	Short Term	2.30	-	[ICRA]A3	-	-	-	-	-	-	-

Amount in Rs. crore *As on March 31, 2019

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 click here

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 Loan- Old	FY2012	NA	FY2024	21.60	[ICRA]BBB- (Negative)
NA	Term Loan- New	FY2018	NA	FY2028	94.00	[ICRA]BBB- (Negative)
NA	Cash Credit	NA	NA	NA	50.00	[ICRA]BBB- (Negative)
NA	Bank Guarantee	NA	NA	NA	3.50	[ICRA]A3
NA	Standby line of credit	NA	NA	NA	2.00	[ICRA]A3
NA	Forward Cover	NA	NA	NA	2.30	[ICRA]A3

Source: Lagnam Spintex Limited

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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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.

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