May 19, 2020

Nahar Industrial Enterprises Limited: Ratings downgraded to [ICRA]BBB+/ [ICRA]A2; outlook remains negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facility (Cash Credit)	630.00	630.00	[ICRA]BBB+ (Negative); downgraded from [ICRA]A-(Negative); outlook remains Negative
Long-term fund-based bank facility (Term Loan)	259.59	259.59	[ICRA]BBB+ (Negative); downgraded from [ICRA]A-(Negative); outlook remains Negative
Long-term unallocated limits	50.00	50.00	[ICRA]BBB+ (Negative); downgraded from [ICRA]A-(Negative); outlook remains Negative
Short-term non-fund based (Letter of Credit)	105.13	105.13	[ICRA]A2; downgraded from [ICRA]A2+
Total	**1,044.72**	**1,044.72**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action reflects expected pressures on Nahar Industrial Enterprises Limited's (NIEL or the company) operating performance and financial risk profile in the near term, owing to COVID-19-led demand-side pressures as well as disruptions in operations following the domestic lockdowns. Given the sensitivity of demand in the downstream segments (fabrics and apparels) to consumer sentiment and discretionary spending, the demand for fabrics as well as cotton yarn is likely to be severely impacted in FY2021. As a result, ICRA expects a continued decline in the company's revenues, profit margins and in turn coverage metrics for FY2021, following a moderation witnessed in the past two years.

As lockdowns across several regions are getting lifted gradually, the company has started operating textile division at partial capacity, with operations continuing throughout in the sugar segment. Nevertheless, potential deferment of orders and expectations of gradual uptick in demand are likely to impact its performance in H1 FY2021, in line with the other spinning/ fabric companies, given that the textile segment accounts for more than 90% of NIEL's revenues and operating profits. Apart from sub-optimal capacity utilisation, high-cost cotton stocked at the end of March 2020, and subsequent decline witnessed in yarn realisations is likely to result in a contraction in contribution margins of spinners. This together with possible delays in payments from buyers owing to operational challenges is likely to exert performance and liquidity pressures in H1 FY2021. In this context, ICRA continues to draw comfort from demonstrated track record of timely funding support from NIEL's promoter Group, healthy financial flexibility at the Group level and a comfortable liquidity cushion maintained in the company's fund-based working capital limits. While ICRA expects a material improvement in the company's performance from H2 FY2021 onwards, a prolonged impact on demand which results in a higher-than-expected impact on performance, coverage metrics and working capital cycle, may warrant a review of the ratings assigned.

The ratings continue to draw strength from NIEL's two-decade-long track record in the textile business with an established market presence and distribution network, and the operational and financial flexibility available to the company as a part of the Ludhiana (Punjab) based Nahar Group. Nahar is one of the largest textile groups in the country with vertically integrated operations from spinning to garmenting. Further, the ratings derive comfort from the company's large-scale operations, partial forward integration into weaving and presence in the sugar sector. This increases the value addition and diversification, while moderating the impact of cyclicality in the spinning industry. The ratings, however, continue to be constrained by the commoditised nature of the company's products, which coupled with the fragmented industry structure result in limited pricing power, keeping profitability under check. Further, the ratings factor in the high working capital intensity of NIEL's operations because of the seasonal nature of cotton availability that requires stocking during the harvest season, keeping the leverage high and profitability vulnerable to volatility in cotton prices.

Negative outlook on the rating reflects a near term pressure on NIEL's credit profile given the expected decline in revenues and profitability, and sizeable repayment obligations. Although ICRA expects timely infusion of funds by the promoter Group to bridge the gap between the accruals and repayment obligations, any delay in the same or stretch in the liquidity position may result in added pressure on the ratings.

Key rating drivers and their description

Credit strengths

Extensive track record in the textile business, with an established market presence and distribution network – In over three decades in the textile sector, NIEL has established a strong and widespread distribution network. Together with a value-added product profile, this has helped the company achieve healthy production levels across product segments.

Large-scale and integrated textile capacities; modest presence in sugar sector provides diversification benefits – NIEL is one of the leading yarn manufacturers in India, with an installed capacity of about 2.2 lakh spindles and 7,600 rotors. Although NIEL phased out ~45,000 old spindles (equivalent to ~17% of its earlier spindle count of ~2.6 lakh) in FY2020, it remains among the large yarn manufacturers in India (considering average spindle count of ~28,000-30,000 per unit in India) with its available capacity of 2.2 lakh spindles. Further, its spinning operations are partially forward integrated into weaving (~30-40% of the yarn production is consumed in-house) with an installed capacity of 515 looms and fabric-processing capacity of 58.4 million metres per annum. This increases the extent of value addition in the company's operations. While the textile business remains its mainstay, the company is also present in the sugar sector with an installed cane crushing capacity of 4,000 tonne per day along with a 16-MW co-generation power plant in Punjab. Even though the segment's contribution to the company's revenues is low at 9-12%, it provides diversification benefits.

Operational and financial flexibility as part of the Nahar Group – NIEL is a part of the Ludhiana-based Nahar Group, which is one of the largest and oldest textile groups in the country with vertically integrated operations from spinning to garmenting and retailing. Other companies in the Nahar Group include Monte Carlo Fashions Limited[1], Oswal Woollen Mills Limited[2], Nahar Spinning Mills Limited, Nahar Capital and Financial Services Limited[3], Nahar Poly Films Limited and Vanaik Spinning Mills Limited. The Group has a demonstrated track record of extending regular and timely funding support across Group entities, depending on the requirements. For instance, promoters infused ~Rs. 39 crore in NIEL during FY2020 and intend to infuse an additional Rs. 10 crore during Q1 FY2021 to ensure comfortable cash flows in light of performance pressures being witnessed in the sector.

[1] *ICRA has ratings outstanding of [ICRA]AA-(Stable) and [ICRA]A1+ for Monte Carlo Fashions Limited*

[2] *ICRA has ratings outstanding of [ICRA]A(Negative) and [ICRA]A1 for Oswal Woollen Mills Limited*

[3] *ICRA has rating outstanding of [ICRA]A1+ for Nahar Capital and Financial Services Limited*

Credit challenges

Weakened debt coverage metrics amid pressures on profitability, while repayment obligations remain sizeable – Given the fixed as well as working capital intensive nature of operations, NIEL's dependence upon debt, like other domestic spinning companies, has remained high over the years. However, given the limited outgo towards capital expenditure (capex) during the past couple of years, NIEL's term borrowings declined from a peak level of Rs. 642.2 crore as on March 31, 2014 to Rs. 190.4 crore as on March 31, 2020(E). This facilitated an improvement in the company's financial leverage (Total Debt/Tangible Net Worth) to 0.9 time as on March 31, 2020(E) from 2.2 times as on March 31, 2014. Although the company's annual debt repayment obligations are also scheduled to decline to ~Rs. 55-65 crore from FY2021 onwards vis-a-vis more than Rs. 100..0 crore in FY2020, these remain sizeable. Together with decline in revenues and profitability amid pressures on performance, this has resulted in a consistent weakening in the company's debt coverage metrics over the last three years. This is corroborated by an estimated decline in the company's interest coverage ratio and debt-service coverage ratio (DSCR) to 1.4 time and 0.7 time, respectively, in FY2020(E) from 1.8 times and 0.8 time, respectively, in FY2019 and 2.1 times and 1.0 time, respectively, in FY2018. While the company's performance in FY2019 was affected by an adverse demand-supply scenario in the sugar segment, the performance in FY2020 was affected because of pressures in the cotton spinning segment. As domestic cotton prices remained uncompetitive vis-a-vis international prices during much of H1 FY2020, there were pressures on export demand. This together with weakness in demand from the domestic downstream segments resulted in a pressure on yarn realisations and contribution margins in FY2020. The pressure on the company's revenues and profitability is expected to continue in FY2021 as well, due to disruption in operations and decline in demand due to COVID-19 pandemic. This is expected to weaken the company's debt protection metrics further in FY2021, despite lower repayments. ICRA, however, continues to draw comfort from the timely infusion of funds by the promoter Group companies which has helped the company maintain a comfortable liquidity profile, with an average cushion of ~Rs. 80-100 crore in its fund-based working capital limits. Nevertheless, besides timely funding from promoters, recovery in revenue and profitability remain imperative for a comfortable credit profile.

Susceptibility of profitability to volatility in cotton prices – Like other entities in the spinning sector, NIEL stocks cotton during the harvest season (from October to March) to meet a significant portion of its requirement during the off season. This stocking exposes the company to fluctuations in cotton and yarn prices during the non-harvest period as the company's procurement cost is fixed while yarn realisation fluctuates with cotton prices, which are driven by domestic and global factors. This was also witnessed in FY2020, as a sharp decline in cotton yarn realisations during H1 FY2020 resulted in a pressure on the spinners' profitability, particularly in Q2 FY2020, given the high cost of cotton carried from the previous stocking season. Like last year, demand-led pressures have resulted in a steep correction in cotton yarn realisations post conclusion of the harvesting and stocking season for cotton this year as well, which is shrinking contribution margin for the spinners.

Commoditised nature of products and fragmented industry structure result in limited pricing power, keeping profitability under check – The spinning and weaving industries are highly fragmented with a significant share of the unorganised segment. While NIEL manufactures a wide variety of yarns and fabrics with varying levels of value addition, its product portfolio continues to be concentrated on medium-count yarns and low-to-medium, value-added mass segment fabrics. As a result, it has limited pricing power, which keeps its profitability under check.

Liquidity position: Adequate

Severe pressures on NIEL's profitability since FY2019 have moderated its liquidity profile. Nevertheless, it remains **adequate**, largely supported by the funding support from promoter Group companies. In FY2020, the promoter Group infused Rs. 39 crore in the company in the form of preference share capital, with plans to infuse an additional Rs. 10 crore in Q1 FY2021. Adequate liquidity is reflected in the availability of unutilised working capital limits to the extent of

~Rs. 80-100 crore vis-a-vis drawing power in FY2020 as well as April 2020. As the company's working capital levels peak during the second half of every fiscal on account of cotton stocking, the peak limit utilisation typically remains around 85%. Nonetheless, even during the peak stocking period, the buffer between drawing power and limit utilisation remained in excess of Rs. 80 crore.

Rating sensitivities

Positive triggers – Given the negative outlook on the company's long-term rating, a rating upgrade in the near term is less likely. Nevertheless, the outlook may be revised to stable if there is a healthy recovery in the company's scale of operations along with a sustainable improvement in its profitability, which results in an improvement in its debt-coverage metrics and makes it self-sufficient to fund its debt repayments and incremental working capital margin requirements. Further, efficient working capital management, which improves the company's liquidity position could be a positive rating trigger.

Negative triggers – The ratings could be downgraded if there is a sustained pressure on the company's sales growth and profitability. Additionally, NIEL's rating would be prone to a downgrade if a delay in fund infusion by the promoters, stretch in working capital cycle or a sizeable capex weakens its liquidity position, taking the average utilisation to more than 85% of lower of sanctioned limits or drawing power on a sustained basis and/or results in an increase in the company's leverage and deterioration in its debt protection metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry - Spinning Rating Methodology for Entities in the Textiles Industry – Fabric Making Rating Methodology for Entities in the Sugar Industry
Parent/Group Support	Ratings factor in the financial flexibility from being a part of the established Ludhiana-based Nahar Group
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

Incorporated in 1983, NIEL is primarily involved in cotton spinning (with an installed capacity of about 2.2 lakh spindles and 7,600 rotors) and weaving (with an installed capacity of 515 air-jet looms and a fabric processing capacity of 58.4 million metre per annum). In addition, it runs a sugar unit with a capacity of crushing 4,000 tonne of sugarcane per day. NIEL's manufacturing units are mostly located in Punjab, with spinning units in Lalru, Ludhiana (both in Punjab) and Bhiwadi (Rajasthan). The weaving and processing unit is based in Lalru and the sugar unit in Amloh (Punjab).

NIEL is a part of the Ludhiana-based Nahar Group, one of the largest and oldest textile groups in the country with vertically integrated operations from spinning to garmenting and retailing. The other major companies in the Nahar Group include Monte Carlo Fashions Limited, Oswal Woollen Mills Limited, Nahar Spinning Mills Limited and Nahar Capital and Financial Services Limited.

In FY2019, the company reported a net loss of Rs. 21.6 crore on an operating income of Rs. 1,866.2 crore compared to a net profit of Rs. 17.2 crore on an operating income of Rs. 1,758.8 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019	9M FY2020 (provisional)^
Operating Income (Rs. crore)	1758.8	1866.2	1165.9
PAT (Rs. crore)	17.2	(21.6)	(22.1)
OPBDIT/OI (%)	8.4%	6.6%	5.2%
RoCE (%)	5.5%	3.1%	NA
Total Outside Liabilities/Tangible Net Worth (times)	1.8	1.6	NA
Total Debt/OPBDIT (times)	6.8	7.2	NA
Interest Coverage (times)	2.1	1.8	1.3
DSCR	1.0	0.8	NA

Source: NIEL's Annual Reports and ICRA research

^ based on provisional financials reported by the company; NA: Not available

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for the past three years:

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018
					19-May-2020	29-Nov-19	26-Nov-2018	19-Jul-2018	15-Sep-2017
1	Cash Credit	Long Term	630.00	-	[ICRA]BBB+ (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
2	Term Loan	Long Term	259.59	237.40	[ICRA]BBB+ (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
3	Unallocated Limits	Long Term	50.00	-	[ICRA]BBB+ (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
4	Letter of Credit	Short Term	105.13	-	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	[ICRA]A1	[ICRA]A1
5	Commercial Paper	Short Term	-	-	-	-*	[ICRA]A2+	[ICRA]A1	-

*Amount in Rs. crore; *rating reaffirmed and withdrawn*

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	NA	NA	NA	630.00	[ICRA]BBB+ (Negative)
NA	Term Loan	FY2011	NA	FY2029	259.59	[ICRA]BBB+ (Negative)
NA	Unallocated Limits	NA	NA	NA	50.00	[ICRA]BBB+ (Negative)
NA	Letter of Credit	NA	NA	NA	105.13	[ICRA]A2

Source: NIEL

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

Nidhi Marwaha
+91 124 4545 337
nidhim@icraindia.com

Pratika Bhandari
+91 124 4545 321
pratika.bhandari@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@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

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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
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,
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