September 29, 2020

Reliance Chemotex Industries Limited: Ratings upgraded to [ICRA]BBB-/[ICRA]A3; outlook revised to Stable from Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	13.76	46.20	[ICRA]BBB-; Upgraded from [ICRA]BB+; Outlook revised to Stable from Positive
Cash Credit	33.00	33.00	[ICRA]BBB-; Upgraded from [ICRA]BB+; Outlook revised to Stable from Positive
Stand by Line of Credit	2.00	2.00	[CRA]A3; Upgraded from [ICRA]A4+
Letter of Credit	30.00	30.00	[CRA]A3; Upgraded from [ICRA]A4+
Credit Exposure Limit	5.50	5.50	[CRA]A3; Upgraded from [ICRA]A4+
Unallocated Limits	38.66	6.22	[ICRA]BBB-/[ICRA]A3; Upgraded from [ICRA]BB+/[ICRA]A4+; Outlook on long-term rating revised to Stable from Positive
Total	**122.92**	**122.92**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings upgrade notes the improvement in the company's margins in FY2020, which is expected to be sustainable in nature and grow further, driven by the movement into better-margin products through the ongoing modernisation capex. Going forward, its margins are likely to be supported by the reduction in the power tariff rate with effect from February 2020, along with the ongoing installation of solar capacity of 3-3.5 MW estimated to be completed by FY2022. The ratings factor in the strengthening of Reliance Chemotex Industries Limited's (RCIL) net worth position, aided by raising of additional equity capital through rights issues, which were utilised to fully redeem its preference share capital leading to savings on dividend outflow (on preference shares) and a sustainable improvement in the capital structure. ICRA notes that RCIL is in the midst of a debt-funded capex of ~Rs. 52.0 crore for expansion and modernisation of its manufacturing facility, which will increase the flexibility of its manufacturing capabilities and operational efficiencies. The company had successfully completed the first phase of the capex and is in the process to commence the second phase of the capex. Though the capex is debt-funded, low interest rates under the state policy scheme and ballooning repayment regime remain a source of comfort. However, commensurate returns, timely completion of the remaining capex and benefits from the capex in terms of cost efficiencies are yet to be seen. Further, in the current fiscal, through better working capital management mainly on the debtors front, RCIL has shored up liquidity in the form of fixed deposit, which is likely to continue as buffer of ~Rs. 10-15 crore. Going forward, this will support its liquidity position. The ratings continue to reflect the extensive experience of the company's promoters in the textile industry, its diversified geographical presence and low working capital intensity of business, driven by prudent working capital management with a favourable receivable cycle.

The ratings, however, remain constrained by the vulnerability of the company's profitability to adverse fluctuations in the raw material prices and limited bargaining power with its suppliers, in an intensively competitive man-made yarn industry, which limits pricing flexibility. The ratings note RCIL's exposure to foreign exchange rate risk, given the presence of sizeable exports in the business. However, the risk is mitigated to an extent by active forward hedging implemented by the company. ICRA also takes note of the return indicators, which are likely to moderate in the near term on account of the ongoing debt-funded capex. The ratings consider RCIL's average coverage indicators, which improved in FY2020 over FY2019 and yet remain moderate. The ratings factor in the likely impact of the Covid-19 pandemic on the company's top line during the current fiscal, which was impacted in Q1 FY2021 because of the lockdown. Nevertheless, the capacity utilisation reached 85% in Q2 FY2021 and is expected to reach the pre-Covid-19 levels in H2 FY2021.

The Stable outlook on the [ICRA]BBB- rating reflects ICRA's opinion that RCIL will continue to benefit from the extensive experience of its promoters, measures for reducing operating costs, strong net worth and adequate liquidity position.

Key rating drivers and their description

Credit strengths

Established track record of promoters in textile industry – The promoter, Mr. S. L. Shroff and family has been in the textile business for over four decades. Over the years, the company has established strong relationship with prominent suppliers in the domestic market. Furthermore, it has developed a strong clientele in both domestic and international market, which has diversified its geographical presence and has resulted in repeat orders.

Improved capital structure in FY2020 and strengthening of net worth base – The company's capital structure remains comfortable as indicated by a low gearing of 0.6 times as on March 31, 2020, against 1.2 times as on March 31, 2019, driven by redemption of preference share capital and controlled working capital borrowings. In August 2019, it had fully redeemed the preference share capital of Rs. 23.1 crore leading to reduction in debt levels. The redemption of preference share capital was funded by raising equity capital of Rs. 23.2 crore through the rights issue in July 2019. This has strengthened its net worth base, which increased to Rs. 98.1 crore as on March 31, 2020 from Rs. 66.9 crore as on March 31, 2019, resulting in an improved capital structure.

Benefits derived from TUFS and the Rajasthan Investment Promotion Scheme, 2014 under the Rajasthan State Government – The company is eligible for various Central and state government incentives such as interest subsidy benefits under the Technology Upgradation Fund Scheme (TUFS) and the Rajasthan Investment Promotion Scheme, 2014, which effectively reduces the interest cost and payback period to a large extent.

Anticipated improvement in cost structure supported by upgradation capex and reduction in power cost – In FY2020, the company had capitalised a part of its ongoing capital expenditure of Rs. 12.9 crore (total capex of Rs. 52.00 crore), which involved replacement of some old spindles and other research and development expenses to improve the efficiency of the unit. This led to some improvement in its operating margin, coupled with other factors. Further, the reduction in power tariff, with effect from February 2020, is likely to lead to savings in the power cost in the near term and support its operating margin. Further, at present, RCIL is in the process of setting up solar panels at its manufacturing unit in Udaipur of 3-3.5 MW, which shall be successfully implemented by FY2022. The same is likely to reduce the company's power cost in the future.

Credit challenges

Relatively moderate coverage indicators and debt protection metrics – The company's coverage indicators continue to remain moderate, with interest coverage of 2.5 times and TD/OPBDIT of 1.9 times in FY2020, compared to interest coverage of 2.0 times and TD/OPBDIT of 3.1 times, respectively, in FY2019 due to improvement in the operating profitability and reduction in the interest expenses. Further, the redemption of preference share capital of Rs. 23.08 crore in August 2019 led to savings on dividend (i.e. treated as interest expenses) outflow in the business in FY2020. Nevertheless, the adjusted interest coverage, excluding interest paid to supplier of raw material, stood at 2.9 times in FY2020.

Return indicators likely to moderate due to ongoing debt-funded capex – RCIL has regularly invested in capex over the last few years. It has planned another capex and modernisation programme for its manufacturing facility, which is at present under progress. The company expects to incur a capex of Rs. 52.0 crore in two phases, which shall be funded through a mix of debt (i.e. term loan of Rs. 35.5 crore) and unsecured loans, sales proceeds of old machinery and internal accruals. It has successfully completed the first phase of this capex (i.e. replacement of 6,240 spindles and have allocated some of the older spindles for research and development process). The company is in the process to commence the second phase of the capex. The ongoing capex (to expansion and modernisation of the facility) is expected to be fully operational by FY2022 and shall lead to better production efficiencies and output. However, given the debt-funded nature of the capex, the external long-term debt levels are likely to rise in the near term. ICRA draws comfort from the ballooning repayment schedule and low effective interest on the sanctioned loan, which enhances the overall project viability. However, the lack of commensurate returns from the capex will negatively impact the key credit metrics over the short to medium term.

Profitability vulnerable to raw material price movements due to low bargaining power and forex fluctuations – The company's key raw materials include polyester staple fibre (PSF), viscose staple fibre (VSF) and acrylic fibre. The raw material procurement is mainly made from the domestic market. The raw material prices are primarily controlled by the large suppliers, offering RCIL limited bargaining power and pricing flexibility. However, the company is steadily diversifying its supplier base to improve its bargaining power. Further, the raw materials are crude oil derivatives, with its profitability remaining a function of the extent of pass-on arrangements with its clients. Being a net exporter, there is exposure to forex movements (Euro and US dollar). The company has a net foreign receivable position and primarily hedges its receivables through forward contracts. The active forex hedging mechanism reduces the susceptibility of its margins to unfavourable forex movement risks to a large extent.

Intense competition in textile industry – RCIL faces competition from international as well as domestic yarn manufacturers. In the domestic market, there is intense competition and fragmentation, limiting the pricing power of the textile companies and affecting their margins. ICRA takes note of the decline in its revenue and profitability in Q1 FY2021 over Q1 FY2020 because of the Covid-19 pandemic-induced lockdown. Though the company's revenues recovered in Q2 FY2021, the extent of the recovery during the full year, in terms of top line and profits, will be a key credit monitorable.

Liquidity position: Adequate

RCIL's liquidity profile remained **adequate** as reflected by 67% utilisation of working capital limits during the last twelve months, reflecting sufficient buffer against its sanctioned working capital limits. The company has reported positive cash flows from operations during the last five years, supported by reasonable profits from the business. With the ongoing capex, its long-term debt is likely to increase. However, the same shall be supported by healthy cash accruals from the business in the medium term and the subsequent years. In Q2 FY2021, the company has created fixed deposit receipts (FDR) of Rs. 14.5 crore with the bank, which is expected to continue as additional buffer in the system.

Rating sensitivities

Positive triggers – ICRA could upgrade RCIL's rating if the company demonstrates a steady improvement in its operating margin and generates healthy return from the capex, which will improve the return indicators in the near term. Moreover, an improvement in the adjusted (for interest paid to suppliers against raw materials) interest coverage to over 3.5 times, on a sustained basis, shall trigger a rating upgrade.

Negative triggers – Negative pressure on RCIL's rating could arise if it is unable to sustain its operating margin at FY2020 levels. Moreover, inability to generate commensurate return from its debt-funded capex or maintain an adequate liquidity and inability to maintain adjusted interest coverage above 2.8 times, on a sustained basis, shall trigger a downward revision in ratings.

Analytical approach

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

About the company

Incorporated in 1977, RCIL manufactures synthetic and blended yarn. The company's product count ranges from Ne 6s to Ne 50s in single, double and multi-ply yarn. RCIL is promoted by Mr. S. L. Shroff. His son, Mr. Sanjiv Shroff, is the company's Managing Director at present. The company's shares have been listed on the Bombay Stock Exchange since 2001.

Based out of Mumbai, the company has branch offices in Kolkata and Delhi, while its manufacturing facility is in Udaipur, Rajasthan, with an installed capacity of 53,280 spindles.

For the three-month period that ended on June 30, 2020, RCIL reported a net loss of Rs. 1.4 crore on an operating income (OI) of Rs. 40.8 crore, against a profit after tax (PAT) of Rs. 3.5 crore on an OI of Rs. 75.0 crore for the three-month period that ended on June 30, 2019.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	324.4	296.8
PAT (Rs. crore)	4.1	9.3
OPBDIT/ OI (%)	8.2%	9.6%
PAT/OI (%)	1.3%	3.1%
Total Outside Liabilities/Tangible Net Worth (times)	2.3	1.3
Total Debt/OPBDIT (times)	3.1	1.9
Interest Coverage (times)	2.0	2.5
Interest Coverage (times)*	2.3	2.9

**adjusted for interest paid to suppliers*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding as on March 31, 2020	Rating	FY2020	FY2019	FY2018
					29-Sep-2020	18-Sep-2019	03-Jan-2019	15-Feb-2018
1	Term Loans	Long Term	46.20	16.22	[ICRA]BBB- (Stable)	[ICRA]BB+ (Positive)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)
2	Cash Credit	Long Term	33.00	-	[ICRA]BBB- (Stable)	[ICRA]BB+ (Positive)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)
3	Stand by Line of Credit	Short Term	2.00	-	[ICRA]A3	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+
4	Letter of Credit	Short Term	30.00	-	[ICRA]A3	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+
5	Credit Exposure Limit	Short Term	5.50	-	[ICRA]A3	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+
6	Unallocated Limits	Long Term/Short Term	6.22	-	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BB+ (Positive)/ [ICRA]A4+	[ICRA]BB+ (Stable)/ [ICRA]A4+	[ICRA]BB+ (Stable)/ [ICRA]A4+

Amount in Rs. crore

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 No	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	FY2015	NA	FY2022-FY2028	46.20	[ICRA]BBB- (Stable)
NA	Cash Credit	NA	NA	NA	33.00	[ICRA]BBB- (Stable)
NA	Stand by Line of Credit	NA	NA	NA	2.00	[ICRA]A3
NA	Letter of Credit	NA	NA	NA	30.00	[ICRA]A3
NA	Credit Exposure Limit	NA	NA	NA	5.50	[ICRA]A3
NA	Unallocated Limits	NA	NA	NA	6.22	[ICRA]BBB- (Stable)/[ICRA]A3

Source: Reliance Chemotex Private Limited

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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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