

**Rating Rationale**  
**Reliance Spinning Mills Limited**

**Rating**

| Facility/ Instrument       | Amount<br>(Rs. In Million) | Rating <sup>1</sup>           | Rating Action |
|----------------------------|----------------------------|-------------------------------|---------------|
| Long Term Bank Facilities  | 999.39                     | CARE-NP BBB- [Triple B Minus] | Assigned      |
| Short Term Bank Facilities | 5,080.00                   | CARE-NP A3 [A Three]          | Assigned      |
| <b>Total facilities</b>    | <b>6,079.39</b>            |                               |               |

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BBB-’ to the long term bank facilities and ‘CARE-NP A3’ to the short term bank facilities of Reliance Spinning Mills Limited (RSML).

**Detailed Rationale & Key Rating Drivers**

The ratings assigned to the bank facilities of RSML derive strength from established track record of operations of the company along with resourceful and experienced promoters in manufacturing industries, healthy operational and financial profile characterized by growth in sales and moderate profitability parameters and debt service coverage indicators in FY19 (audited, refers to 12 months period ended mid-July 2019) and H1FY20 (Unaudited, refers to 6 months period ended mid-January 2020), however exposed to project related risk. The ratings also factor in established presence in both domestic and export market, diversified product profile and support from the government policies stimulating export sales. The ratings are however, constrained by project risk associated with entirely debt-funded capex leading to deterioration in the debt service coverage indicators, where implementation is yet to start, financial closure is yet to be achieved and the size of the project is ~1.9x its net worth at the end of FY19. The ratings are further constrained by company’s exposure to contingent liability from Nepal Electricity Authority (NEA), working capital intensive nature of operations, raw material price volatility risk with susceptibility to adverse foreign exchange price movements and exposure to volatile interest rate.

The impact of disputed contingent liability related to NEA and timely completion of the large sized capex within envisaged cost estimations remain the key rating sensitivities. Also, ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risk related to raw materials are the key rating sensitivities.

**Detailed Description of the Key Rating Drivers**

**Key Rating Strengths**

*Established track record of operations of the company with resourceful and experienced promoters in manufacturing industries*

RSML has an operational track record of more than 20 years in yarn manufacturing industry. RSML is a joint venture of two leading groups of Nepal i.e. Golyan Group and MS Group and is promoted by Mr. Pawan Kumar

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

Golyan, Chairman of the Golyan Group and Mr. Shashi Kant Agarwal, Managing Director of MS Group. The company is managed under the overall guidance of its three member Board of Directors (BoD) who possess wide experience in the related field. Mr. Pawan Kumar Golyan, Chairman & Managing Director of RSML is also Chairman of NMB Bank. He is also currently the President of Nepal Yarn Manufacturing Association. Mr. Shashi Kant Agarwal, Director in RSML has 30 years of experience in Trade and Industry. Mr. Agarwal is also currently, President of Nepal Sugar Mills Association and Executive Member of Nepal India Chamber of Commerce of Industry. Mr. Akshay Golyan, Director, has around 5 years of experience in manufacturing and real estate sector.

***Healthy operational and financial profile characterized by growth in sales and moderate profitability parameter at the end of FY19 and H1FY20***

Total revenue of the company reported a growth of 22% in FY19 on account of growth in quantity sold coupled with improvement in average price realization. Also, export incentive received by the company increased during FY19. Company achieved PBILDT margin of 10.07% with PBILDT of Rs. 759 Mn during FY19. PBILDT margin reduced slightly in FY19 despite growth in sales majorly on account of increase in cost of raw material consumed and increase in employee cost. RSML achieved PAT of Rs. 176 Mn in FY19 with PAT margin of 2.33%. Despite growth in PBILDT in absolute value terms, PAT of the company was negatively impacted in FY19 due to loss of Rs. 119 Mn incurred by the company on sale of fixed assets of the POY (Partially Oriented Yarn) plant. During H1FY20, company achieved sales of Rs. 3,668 Mn with PBILDT of Rs. 362 Mn and PBT of Rs. 171 Mn.

***Moderate debt service coverage indicators of the company at the end of FY19 and H1FY20, however exposed to project related risk***

Debt-equity ratio of the company was low at 0.88x at the end of FY19 which declined from 1.16x at the end of FY18, on back of repayment of term loans and increase in net worth due to accretion of the profit to the net-worth. Total gearing ratio of the company was moderate at 2.26x at the end of FY19 which improved from 2.57x at the end of FY18 with comfortable interest coverage ratio of 4.73x in FY19 (FY18: 3.90x). Total debt/ GCA for FY19 was moderate at 6.81x. During H1FY20, debt-equity ratio of the company improved to 0.50x with overall gearing of 1.58x and interest coverage ratio of 4.64x. However, the upcoming project of the company with entirely debt-funded capex of Rs. 3,000 Mn to be funded in two tranches of Rs. 1,500 Mn each in FY20 and FY21 is expected to deteriorate the debt service coverage indicators.

***Established presence both in domestic and export market***

RSML has international market in India, Turkey, UK, Bangladesh and Yemen and around 70% of total sales generated by the company is through export sales mainly to India and Turkey. RSML is a major exporter of Nepal contributing nearly 6-7% of total exports of the country. The company has a strong dealer network in Nepal, India and Turkey as well.

***Diversified product profile***

RSML is one of the largest producers and exporters of polyester, viscose and acrylic yarns and its blend. Company has strength and expertise to deliver Nepal's largest quantities of grey, dyed and mélange yarns and also a variety of synthetic yarns in a variety of blends and counts for all kinds of weaving and knitting requirements. Further, with capacity expansion the company will be in position to develop new products and cater to wide range of customer.

***Support from the government policies stimulating export sales***

RSML's revenue from export sales is supported by both domestic and foreign government policies. As per the new provision in FY19, Nepal government has announced cash incentives of three percent on yarn made out of polyester, viscose, acrylic and cotton in a bid to boost export earnings and manage increasing pressure on balance of payment. Also the new provision now provides incentives to goods exported even to India, whereas in the previous provision, the incentives were given only to goods exported to the third country. This increase in export incentive by the government is expected to further boost export sales of synthetic yarn from Nepal. Government's continued thrust on increasing export from Nepal is likely to benefit the yarn spinning manufacturers like RSML. However, any change in the incentive policy of the Government will have an impact on the profitability of the company.

**Key Rating Weaknesses**

***Project risk associated with entirely debt-funded capex leading to high gearing levels, where implementation is yet to start, financial closure is yet to be achieved and the size of the project is ~1.9 x its net worth as on mid-July, 2019***

The estimated total cost of capacity expansion by 9,360 MT in cotton and synthetic spun yarn is envisaged at Rs. 3,000 Mn which is proposed to be funded entirely through term loan from Banks. The company is yet to be achieve the financial closure for the project. Company plans to take disbursement of loan in two tranches of Rs. 1,500 Mn each in FY20 and FY21 as the capacity addition will be done in two phases with synthetic spun yarn unit coming into operation during July 2020 and cotton spun yarn unit during July 2021. Size of the project compared to company's existing net worth is high at ~1.9 times.

***Exposed to contingent liability from Nepal Electricity Authority (NEA)***

During FY19, RSML had received demand notice from Nepal Electricity Authority (NEA) towards additional electricity charges as dedicated feeder charges for the period Aug 2016 to April 2018. The matter was referred to the court, however recently the high court has referred back the matter to the Review Committee under Nepal Electricity Distribution Regulation. Impact of this contingent liability on the books of the company if the same crystalizes will be a key rating sensitivity.

***Working capital intensive nature of operations, with high reliance on bank finance for funding***

The operations of the company are working capital intensive in nature as it is involved in manufacturing yarns by primarily importing raw materials through Letter of Credit from countries like China, India, HongKong, Indonesia, Malaysia and Thailand. The company has to maintain inventory for smooth operations and also extend credit to dealers, which lead to reliance on working capital limits. The month end working capital utilization (Fund based & Non-Fund based) against the drawing power of the company for last 12 months ending mid-January, 2020 was at 78%.

***Exposure to Volatile Interest Rate***

Nepalese banking sectors are fixing interest rate on lending based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile. Therefore, funding from Bank and Financial Institutions is subject to volatile interest rate.

***Exposed to global competition as major sales are exports oriented***

India and Turkey are the major export market for synthetic yarn manufactured by RSML and contributes nearly 70%-75% to total sales. Both India and Turkey are major export markets for most of the other countries which are more competitive in pricing thereby exposing RSML to domestic competition as well as competition from other countries. Also, the export sales of the company are concentrated as top 10 customer base contribute nearly 50% to the total sales. This exposes the company to losing a substantial customer base and revenue if RSML is not able to compete with other countries/local manufacturers.

***About the Company***

Reliance Spinning Mills Limited (RSML) is a public limited company established in the year 1994 and is the largest spinning mill in Nepal. RSML is engaged in manufacturing of Polyester, Viscose, Acrylic/Blended & Polyester Textured Yarns. The company has two factories: Unit A located at Khanar, Sunsari and Unit B located at Duhabi, Sunsari, Nepal. Currently, the total installed manufacturing capacity of the company is 36,000 MT per year. The company is now planning to expand its capacity in two phases by setting up a synthetic spun yarn unit of 4,680 MT and cotton spun yarn unit of 4,680 MT capacity as part of its expansion program and is expected to come in operation during July 2020 and July 2021 respectively.

***Brief Financial Performance during the last 3 years is as follows:***

(Rs. In Million)

| For the year ended Mid July | FY17 (A) | FY18 (A) | FY19 (A)* |
|-----------------------------|----------|----------|-----------|
| Income from Operations      | 5,490    | 6,201    | 7,536     |
| PBILDT                      | 559      | 675      | 759       |
| PAT                         | 111      | 157      | 176       |
| Overall Gearing (times)     | 2.65     | 2.57     | 2.26      |
| Interest coverage (times)   | 3.73     | 3.90     | 4.73      |

\*Audited

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**Annexure 1: Details of the Facilities rated**

| Nature of the Facility     | Type of the Facility   | Amount<br>(Rs. Million) | Rating               |
|----------------------------|------------------------|-------------------------|----------------------|
| Long Term Bank Facilities  | Term Loan              | 999.39                  | <b>CARE- NP BBB-</b> |
| Short Term Bank Facilities | Working Capital Limits | 2,175.00                | <b>CARE-NP A3</b>    |
| Short Term Bank Facilities | Non-Fund Based Limits  | 2,905.00                | <b>CARE-NP A3</b>    |
| <b>Total</b>               |                        | <b>6,079.39</b>         |                      |