Reliance Spinning Mills Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities – Term Loan	2,015.39	**CARE-NP A- [Single A Minus]**	Revised from CARE-NP-BBB+
Short Term Bank Facilities – Working capital loans	2,175.00	**CARE-NP A2+ [A Two Plus]**	Revised from CARE-NP-A2
Short Term Bank Facilities – Bank Guarantee	2,905.00	**CARE-NP A2+ [A Two Plus]**	Revised from CARE-NP-A2
Total facilities	**7,095.39 (Seven Billion Ninety Five million and Three Hundred Ninety Thousand only)**		
Issuer Rating	NA	**CARE-NP A- (Is) [Single A minus Issuer]**	Assigned

** The issuer rating is subject to overall gearing being maintained at 1.30x at the end of FY22*
Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of 'CARE-NP A- (Is)' to Reliance Spinning Mills Limited. Issuers with this rating are considered to offer adequate degree of safety regarding timely servicing of financial obligations in Nepal. Such issuers carry low credit risk.

Also, CRNL has revised the rating to 'CARE-NP A-' assigned to the long-term bank facilities and to 'CARE-NP A2+' assigned to the short-term bank facilities of Reliance Spinning Mills Limited (RSML).

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of RSML considers successful completion and stabilization of phase-1 expansion, improvement in financial risk profile characterized by growth in total operating income, profitability and comfortable debt service coverage indicators of the company during FY21 (audited, refers to 12 months period ended mid-July 2021). The ratings also factor in established track record of operations along with resourceful and experienced promoters in manufacturing industries, established presence in both domestic and export market, diversified product profile and favourable government policies stimulating export sales.
The ratings are however, constrained by project execution risk associated with ongoing capex of the company which is debt-funded leading to moderation in the gearing levels, company's exposure to contingent liability from Nepal Electricity Authority (NEA) and elongated operating cycle.

Timely completion of the ongoing capex within envisaged time and cost estimations and early stabilization thereafter are key rating sensitivities. Furthermore, maintaining the profitability margins and improving its capital structure while rationalizing the debt levels are also the key rating considerations. Also, the unfavourable outcome of contingent liability would be crucial from the credit perspective.

[1]*Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

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 around 25 years in yarn manufacturing industry. RSML is a joint venture of two leading business houses of Nepal namely Golyan Group and MS Group. The company is promoted by Mr. Pawan Kumar 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 members Board of Directors (BoD) who possess wide experience in the related field. Mr. Pawan Kumar Golyan, is the Chairman of the company and is also the President of Nepal Yarn Manufacturing Association. He is also Chairman of Confederation of Banks and Financial Institutions Nepal and member of Industry and Investment Promotion Board under Department of Industry. Mr. Shashi Kant Agarwal, Vice Chairman in RSML has 30 years of experience in Trade and Industry. Mr. Agarwal is President of Nepal Sugar Mills Association and Executive Member of Nepal India Chamber of Commerce of Industry. Mr. Akshay Golyan, Managing Director, has around 6 years of experience in manufacturing and real estate sector.

Diversified product profile and established presence both in domestic and export market though concentrated in overseas market

RSML is engaged in the manufacturing and export of various types of yarn viz. polyester, viscose and acrylic yarns etc. Furthermore, the company has incurred capital expenditure regularly in the past to increase its capacity, product portfolio and for improvement in manufacturing processes. In the ongoing capex; RSML had incurred an expenditure of Rs 1,306 Mn (under Phase -I capex program) which started its commercial operations in Feb 2021. With this, the capacity per annum has increased by 4,680 MT in Vortex Spinning. With this expansion, the company expanded its product portfolio which would help company to diversify its customer case in new segments. Furthermore, the company is expected to gain more competitive advantage through new market and product penetration and enable it to gain stronger hold in the local and overseas market.

Attributed to established presence in industry in Nepal and long track record of operations, the company has developed market for its products in and outside Nepal. The company has a dealer network in Nepal, India and Turkey. Also, RSML has been getting the repetitive orders for the last 12-15 years from its customers and this long-term and close relationship with its customers is reflective of the company's demonstrated ability to provide quality products.

The company generates around 74% though exports and the main export destinations are India and Turkey. Due to high geographic concentration, the firm is also exposed to unfavourable changes in the government policy of that country.

Strong operational profile with above average financial risk profile

The company has been continuously incurring CAPEX in up-gradation of its machinery and increase its product portfolio which has enabled the company to achieve healthy volumetric sales growth from 21,261 MT in FY20 to 28,670 MT in FY21 (FY refer to 12 months' period ended on mid-July). With increase in operations, total revenue of the company improved by 25% in FY21 to Rs. 7,792 Mn. With improvement in sales, the profitability margins of the company have been improving on y-o-y basis in the last 3 years (FY19-FY21). PBILDT margin of the company improved by 419 bps in

FY21 over FY20 and stood at 16.86% in FY21. The increase in operating margins was on account of improvement in production process due to automization which led to savings in wages and reduction in wastages. The change in product mix coupled with economies of scale also impacted the profitability favourably. With improvement in PBILDT and decline in interest cost, profitability of the company increased in FY21. RSML achieved PAT of Rs. 754 Mn in FY21 with PAT margin of 9.68% as compared to Rs. 173 Mn and margin of 2.76% in FY20.

The working capital utilization of the company is at moderate level on account of usage of internal accruals for funding most of the working capital as well as operational requirements. Debt-equity ratio of the company was moderate at 0.55x at the end of FY21 which improved from 0.60x at the end of FY20, on back of increase in equity capital and accretion of the profit to net-worth. Total gearing ratio of the company also stood moderate at 0.93x at the end of FY21 with comfortable interest coverage ratio of 13.98x in FY21. Total debt/ GCA for FY21 was moderate at 2.60x which improved from 6.65x in FY20 due to higher cash generation during the year on account of increase in profits generated.

Favourable government policies stimulating export sales

RSML's revenue from export sales is supported by both domestic and foreign government policies. In order to boost exports from Nepal, Nepal government has announced incentives of three percent on yarn made out of polyester, viscose, acrylic and cotton. Continuation of the government policy is crucial for the company to maintain its profitability.

Key Rating Weaknesses

Project risk associated with entirely debt-funded capex leading to moderate gearing levels

The company is undertaking an expansion project to increase its installed capacity by 9,360 MT per annum in cotton and synthetic spun yarn. The estimated cost is Rs. 3,000 Mn which is envisaged to be funded entirely through term loan from Banks. The financial closure for the same has been achieved. The expansion project is carried out in phased manner. Company has incurred Rs. 1,306 Mn under Phase -I in synthetic spun yarn unit in FY21 which was funded through bank finance. Further, the upcoming phase II project of the company with entirely debt-funded capex of Rs. 1,694 Mn will be availed in FY22.

The synthetic spun yarn unit came into operation from February 2021. Furthermore, the remaining debt of Rs. 1,620 Mn. for funding the cotton spun yarn unit is expected to be disbursed in FY22 and it is expected to the commercial production would commence in August 2022. The company is further planning to increase the capacity by 4,680 MT in the existing synthetic spun yarn unit in FY23. Size of the project compared to company's existing net worth is high at ~1.02 times at the end of FY21 thereby exposing it to its financial flexibility.

Though the capital expansion will increase the installed capacity, however company remains susceptible to risk related with implementation and funding. Any delays in the implementation may impact the company's financial risk profile adversely and is also crucial from credit perspective. The debt funded project is expected to increase gearing levels in the medium term. The company is also exposed towards project execution risk, in terms of completion of the project with-in the envisaged time and cost. However, aforementioned risks are partially offset by the experience of its management team with strong execution skills and the planned capex will be completed in phased manner.

Elongated operating cycle

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 coupled with labour intensive operations. The company has to maintain inventory for smooth operations and also extend credit to dealers, which lead to reliance on working capital limits. The operating cycle of the company was high at 156 days in FY21 on account of substantial inventory days.

Exposed to contingent liability from Nepal Electricity Authority (NEA)

During FY19, Nepal Electricity Authority (NEA) has raised additional demand of Rs. 1,611 Mn towards additional electricity charges as dedicated feeder charges for the period Aug 2016 to April 2018. The said matter is under litigation and the district court has imposed stay order on the demand issued by NEA. Any unfavourable decision against the company would impact its liquidity profile and furthermore, would also be crucial from the credit perspective.

Exposure to raw material price volatility

The entities in textile industry are susceptible to fluctuations in raw material prices. Cotton (one of the main raw material) being an agricultural product, its demand supply situation depends on various natural conditions like monsoons, drought and floods. Being a product of international importance, its price is very volatile depending on the demand-supply situation in the global markets. The price of other raw material, i.e. acrylic yarn is linked to that of crude oil. The general volatility in the crude oil prices also has an impact on the price of this product. Any sudden spurt in these raw material prices might not be passed on to the end customers, instantly, on account of highly fragmented and competitive nature of the industry, which could lead to decline in profitability margins.

Exposed to global competition as major sales are exports oriented

Export to India contribute the maximum in overall exports accounting for approximately 61% on an average. Turkish market accounts for about 12% of total exports in value terms. 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.

The textile industry is inherently cyclical in nature. Any adverse changes in the global economic outlook as well as demand-supply scenario in the exporting market directly impacts operations of the company. Also, the export sales of the company are concentrated as top 10 customer base contribute nearly 74% to the total sales which was 50% of the total sales in FY20. 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. RSML is engaged in manufacturing of Polyester, Viscose, Acrylic/Blended & Polyester Textured Yarns. The company has two manufacturing units located at Khanar, Sunsari and Duhabi, Sunsari, Nepal. The total installed manufacturing capacity of the company is 40,680 MT per year as on mid-July 2021.

Financial Performance:

(Rs. Million)

For the year ended Mid July	2019 (12m, A)	2020 (12m, A)	2021 (12m, A)
Income from Operations	7,423	6,261	7,792
PBILDT Margin (%)	8.35	12.67	16.86
Overall Gearing (times)	1.64	1.54	0.93
Interest Coverage (times)	3.85	5.79	13.98
Current Ratio (times)	1.09	0.92	1.41
Total Debt/ Gross Cash Accruals (times)	7.47	6.65	2.60

A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. In Million)	Rating assigned along with Rating Outlook
Long Term Bank Facilities	Term Loan	2,015.39	**CARE- NP A-**
Short Term Bank Facilities	Working Capital Limits	2,175.00	**CARE-NP A2+**
Short Term Bank Facilities	Non-Fund Based Limits	2,905.00	**CARE-NP A2+**
Total		**7,095.39**	

Contact Us

Analyst
Ms. Anjali Bhandari
+977-01-4012629
anjali.bhandari@careratingsnepal.com

Relationship Contact
Achin Nirwani
+977-9818832909
achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

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