Reliance Spinning Mills Limited

Ratings

Facilities	Amount (Rs. in Million)	Rating[1]	Rating Action
Issuer Rating	**NA**	**CARE NP A- (Is) [Single A Minus Issuer]**	**Reaffirmed**
Long Term Bank Facilities	**3,870 (Increased from 2,015.39)**	**CARE NP A- [Single A Minus]**	**Reaffirmed**
Short-Term Bank Facilities	**5,080.00**	**CARE NP A2+ [A Two Plus]**	**Reaffirmed**
Total Facilities	**8,950.00 (Eight Thousand Nine Hundred and Fifty Million Only)**		

** The issuer rating is subject to overall gearing ratio not exceeding 1.30x at the end of FY23.*
Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP A- (Is)' assigned to Reliance Spinning Mills Limited (RSML). 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 reaffirmed the rating of 'CARE-NP A-' assigned to the long-term bank facilities and 'CARE-NP A2+' assigned to the short-term bank facilities of RSML.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RSML continue to derive strength from its comfortable financial risk profile marked by growing scale of operations, healthy profitability and gross cash accruals coupled with moderate capital structure with adequate debt service coverage indicators of the company during FY22 (Audited, refers to the twelve-month period ended mid-July 2022). The ratings also factor in RSML's established track record of operations along with resourceful and experienced promoters in manufacturing industries, established presence in both domestic and international market, diversified product profile and favourable government policies stimulating export sales.

The ratings, however, remain primarily constrained due to inherent implementation and salability risk associated with the significantly large size on-going debt-funded brown-field expansion project. Consequently, the gearing levels and debt coverage indicators of the company are expected to moderate in the near term due to drawl of fresh term debt for the expansion project. The ratings also factor in substantial dividend payouts by the company during FY22 leading to lower than earlier envisaged net worth base of the company. The ratings continue to factor in the elongated operating cycle of the company, exposure to volatile raw material prices, foreign exchange rate fluctuations, sustained competition particularly for its exports and the company's exposure to contingent liability towards Nepal Electricity Authority (NEA). The ratings, however, take cognizance of the proposed public issuance of the company and likely improvement in capitalization levels thereafter.

Going forward, 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. Deterioration in capitalization structure of the company through substantial outflow of dividend shall also remain a rating sensitivity. Also, any unfavorable outcome regarding contingent liability would be crucial from the credit perspective.

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE 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 groups of Nepal i.e. Golyan Group and MS Group and 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. He is also the President of Nepal Yarn Manufacturing Association and was Vice President of Confederation of Nepal Industry (CNI). Mr. Shashi Kant Agarwal, Vice Chairman in RSML has 30 years of experience in Trade and Industry. Similarly, Mr. Akshay Golyan, Managing Director, has around a decade of experience in manufacturing and real estate sector.

Diversified product profile and established presence both in domestic and export market though majority sales in Indian 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. The company is in process of adding to its product portfolio by setting up a cotton spun yarn, which is likely to commence operation by January 2023. With this expansion, 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.

On account of established presence in industry in Nepal and long track record of operations, the company has developed market for its products within and outside Nepal. The company has an established dealer network in Nepal, India and Turkey. Also, RSML has been getting 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. Around 74% of total sales generated by the company is through exports mainly to India and Turkey out of which export to countries other than India accounted for ~18% of total sales in FY22.

Satisfactory operational profile with above average financial risk profile, albeit moderation likely over near-term amid ongoing debt funded capex

During FY22, the Total Operating Income (TOI) of RSML grew 29.65% year-on-year to Rs. 10,104 Mn. The company has been continuously upgrading its machinery and enhancing its capacity and product portfolio, which has enabled it to achieve healthy volumetric sales growth over the past several years. The growth in TOI in FY22 was also supported by increased average price realization per kg by ~22% from Rs. 265 per kg in FY21 to Rs. 323 per kg in FY22 on account of increase in sales of premium products. Furthermore, with growth in export sales, export incentive provided by the Government of Nepal (GoN) also increased from Rs. 168 Mn in FY21 to Rs. 214 Mn. Incentives from FY23 onwards is likely to be around 8% as per the latest government declaration in October 2022, set to further boost the company's income prospects.

RSML's profitability has remained fairly steady with PBILDT margin of 17.36% in FY22 compared to 16.87% achieved during FY21. Similarly, RSML achieved PAT of Rs. 1,043 Mn in FY22 with PAT margin of 10.32% as compared to Rs. 755 Mn in FY21 with PAT margin of 9.68%. PAT of the company increased majorly on account of growth in PBILDT in FY22 as compared to FY21. The growth was mainly on account of improvement in product mix coupled with economies of scale

Furthermore, the overall gearing of the company has improved over the years on the back of increased accruals and lower working capital borrowings. Accordingly, overall gearing ratio of the company was 0.82x at the end of FY22 which improved from 1.05x PY. Interest coverage ratio also remained comfortable at around 12.28% in FY22 (FY21: 13.99x). Total debt/ GCA of the company for FY22 was moderate at 2.01x which improved from 2.92x in FY21 due to higher cash generation during the year on account of increase in profits generated. However, around Rs. 2,600 Mn of additional term debt associated with the ongoing capex likely to come on the books by FY23 end is likely to lead to some moderation of RSML's gearing levels and debt service coverage indicators for FY23.

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 on exportable goods. Furthermore, on October 2022, GoN has announced to increase the cash subsidy on export incentives for certain products from FY23. Consequently, the export incentives that RSML is eligible for has been revised to 4% for exports up to Rs. 500 Mn and 8% thereafter. 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 leading to expansion of profit margin of RSML. Given that, the ongoing pressure on government revenues amid declining revenue from import, the timely payment of export incentives could impact the cash flows of RSML.

Key Rating Weaknesses

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

The company has been undertaking a completely debt funded expansion project, which is being completed in two phases. Phase I was the synthetic spun yarn unit of 4,680 MT per annum capacity completed in February 2021 with cost of Rs. 1,400 Mn. Phase II is the 8,280 MT per annum cotton-synthetic mix yarn with estimated project cost of Rs. 2,600 Mn. Financial closure for the ongoing project has already been achieved and the unit is expected to come into operation by January 2023. The ongoing capex of Rs. 2,600 Mn is ~0.77 times RSML's tangible net worth as on mid-July 2022. Such large size projects are generally susceptible to inherent implementation risks and consequently any delay in execution of the project may result in cost overrun and impact the currently envisaged timelines for cash flow generation. Apart from that, demand for synthetic yarn is driven by international demand-supply dynamics and susceptible to economic cycles. Hence, there is a salability risk associated with the project in case of sudden drop in demand which may adversely impact the credit profile of the company. However, the company's track record of being able to quickly stabilize large expansions such as the one completed in February 2021 provides some comfort in this regard. Timely completion of the project within envisaged cost parameters and realization of envisaged benefit therefrom would remain crucial from credit perspective.

Over the near term, the company's gearing levels and debt coverage indicators are expected to moderate after the additional term debt associated with project comes on its book, leading to possibility of gearing levels exceeding 1.3x at the end of FY23, more so if the proposed public issuance gets delayed beyond FY23 end. Furthermore, capitalization structure of the company has also weakened somewhat following a substantial dividend payout of ~Rs. 680 Mn during FY22 (for FY21 and FY22). Further substantial payouts that could impact company's capital structure will remain a key monitorable aspect. However, over the medium term, solvency parameters of the company are likely to improve to comfortable levels supported by strong operations of the company along with accretion of additional cash flows from the upcoming unit barring any significant dividend payouts or significant majorly debt funded capex.

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. However, the operating cycle of the company improved to 136 days in FY22 (PY: 156 days) on account of improvement in inventory days.

Exposure to raw material price volatility and foreign currency fluctuation risk

The entities in textile industry are susceptible to fluctuations in raw material prices. The price of RSML's major raw material, i.e. Polyester Staple Fibre (PSF) 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. As a substantial portion of the procurement is on foreign currency, this exposes the company to volatility in foreign currency exchange rates. However, the company has generally been able to fully pass on any such fluctuations, even during the pandemic. Its ability to continue to do so will remain a key monitorable aspect.

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.

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. The ongoing slowdown in global demand for textile due to recessionary trends across various geographies could impact envisaged sales levels over the near term.

Exposed to contingent liability from Nepal Electricity Authority (NEA)

During FY19, Nepal Electricity Authority (NEA) has raised additional demand towards electricity charges as dedicated feeder charges for the period Aug 2016 to April 2018. The said matter is under litigation and was referred to the court, however recently 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.

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 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 2022.

Brief financials of RSML for last three years ending FY22 are given below:

For the Year ended Mid- July,	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	6,261	7,792	10,104
PBILDT Margin (%)	12.67	16.86	17.36
Overall Gearing (times)	1.54	0.93	0.82
Interest Coverage (times)	5.79	13.98	12.29
Current Ratio (times)	0.92	1.41	1.33
Total Debt/ Gross Cash Accruals (times)	6.65	2.60	2.01

A: Audited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	3,870.00	CARE-NP A- [A Minus]
Short Term Bank Facilities	Working Capital Limits	2,175.00	CARE-NP A2+ [A Two Plus]
Short Term Bank Facilities	Non-Fund Based Limits	2,905.00	CARE-NP A2+ [A Two Plus]
Total Facilities		**8,950.00**	

Contact us

Analyst Contact
Ms. Sarina Khakurel
Contact No.: 977-01-4012628
Email: sarina.khakurel@careratingsnepal.com

Mr. Santosh Pudasaini
Contact No.: +977-01-4012629
Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact
Mr. Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:
CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).