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 Rating]**	**Reaffirmed**
Long Term Bank Facilities	**3,727.57 (Decreased from 3,870.00)**	**CARE NP A- [Single A Minus]**	**Reaffirmed**
Short-Term Bank Facilities	**5,580.00 (Increased from 5,080.00)**	**CARE NP A2+ [A Two Plus]**	**Reaffirmed**
Total Facilities	**9,307.57 (Nine Billion Three Hundred Seven Million and Five Hundred Seventy Thousand Only)**		

** The issuer rating is subject to overall gearing ratio not exceeding 1.50x at the end of FY24* (FY refers to the twelve-month period ending mid-July).
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 RSML continue to derive strength from its established business profile and market position amongst Nepalese spinning mills reflective in its steady growth in scale of operations and healthy cash accruals in FY23, despite industry headwinds. The company's resilient business model is also evident in its stable profitability profile in FY23, which is in stark contrast vis-à-vis the sharp decline reported by other similar market players on account of softening input prices leading to lower sales realizations in FY23 amid relatively muted demand scenario, particularly in Turkey, which is one of the major export destinations for Nepalese spinning mills. However, a geographically diversified clientele base coupled with addition of margin accretive product offerings have helped RSML protect its margins in FY23. The ratings continue to factor in adequate debt service coverage indicators of the company during FY23 despite conspicuously elevated gearing levels at the end of FY23 owing mainly to drawl of fresh term debt for capital expenditure, 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 favorable government policies stimulating export sales. Furthermore, the ratings also take cognizance of successful commencement of commercial operations of its brown-field expansion project during FY23. Although the company's ability to achieve capacity utilization at envisaged level of the added capacity remains to be seen for a sustained period, addition of cotton-synthetic mix yarn is likely to boost the company's revenue mix and profitability profile, which bodes favorably for RSML's business prospects going forward.
The ratings, however, are constrained by salability and scaling-up risk associated with the recently completed large size debt-funded expansion project. The sequential moderation in RSML's capital structure and debt protection metrics as on mid-July 2023 also remain key rating constraints. However, RSML's gearing levels and debt coverage indicators are expected to improve from FY24 onwards as no major debt-funded capital expenditure is expected over the near-term. Furthermore, RSML's capital structure is also expected to improve further post completion of its proposed public issuance plans, concrete timelines for which, however,

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

remain uncertain. The ratings continue to take into consideration RSML's elongated operating cycle, 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 also take note of the generous dividend payout history of the company making RSML's capital structure susceptible to larger than expected payouts in the future.

Going forward, the ability of the company to profitably scale up its operations along with rationalization of its debt levels would be the key rating sensitivities. Furthermore, stabilization of the expansion project with sufficient capacity utilization levels to generate cash flows as envisaged will also be the key rating sensitivity. Substantial outflow of dividend leading to material deviation in capital structure than expected shall also remain a monitorable aspect. Also, any unfavorable outcome regarding contingent liability would be crucial from the credit perspective.

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 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 enhanced its product portfolio by setting up a cotton spun yarn, which commenced operations from April 2023. With this expansion, the company is expected to gain more competitive advantage through new market and product penetration, which is expected to enable it to gain stronger hold in the local and overseas market.

On account of established presence with long track record of operations, the company has developed market for its products both 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. This long-term and close relationship with its customers is reflective of the company's demonstrated ability to provide quality products. Around 76% of total income generated by the company is through exports, mainly to India and Turkey, out of which export to countries other than India accounted for ~13% of total income in FY23.

Satisfactory operational performance in FY23 despite industry headwinds

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. During FY23, the company's total quantity sold increased by ~5% year-on-year to 31,098 MT. Despite of increasing volumes, RSML's total operating income (TOI) declined by 1% year-on-year to Rs. 10,006 Mn. This was mainly on account of decrease in average price realization per kg by ~8% to Rs. 306 per kg in FY23 from Rs. 323 per kg in FY22 amid softening of crude prices in FY23 following the peaks of 2HFY22. RSML's income in FY23 also benefited from the favourable change in export incentive structure provided by the Government of Nepal (GoN) (Rs.

486 Mn in FY23 from Rs. 214 Mn in FY22). Consequently, RSML's profitability has remained fairly steady with PBILDT margin of 17.58% in FY23 compared to 17.36% in FY22 despite the moderation in sales realization. Similarly, RSML achieved PAT of Rs. 952 Mn with PAT margin of 9.51% in FY23 as compared to Rs. 1,043 Mn with PAT margin of 10.32% in FY22. PAT of the company decreased slightly on account of increase in interest expenses during FY23 amid increased debt levels and higher interest rates in the market.

Moderately leveraged capital structure and adequate coverage indicators, albeit slight moderation in FY23

The company's gearing levels and debt coverage indicators moderated in FY23 after the additional term debt amounting to Rs. 2,600 Mn associated with debt-funded capex came on its book. Consequently, RSML's gearing levels deteriorated to 1.59x at the end of FY23 (PY: 0.82x). Higher than expected increase in gearing levels in FY23 was also, in part, due to lesser accretion of profits to reserve, than earlier envisaged, amid lower sales realization. Furthermore, delays in getting necessary regulatory approval for public issuance has also deferred the company's deleveraging plans. Additionally, dividend payout of Rs. 341 Mn during FY23 also impacted RSML's gearing levels at the year end. RSML has had a generous dividend payout in FY22 as well (Rs. 683 Mn) and any substantial payouts in future could impact the company's capital structure, which will remain a key monitorable aspect.

In spite of the increased debt levels, RSM's interest coverage ratio remained healthy at 6.54x in FY23 although declining from 12.27x in FY22. Similarly, total debt/ GCA of the company for FY23 shot up to 4.81x from 2.01x in FY22 as total debt had almost doubled during the period.

With commissioning of the expansion project likely resulting in incremental sales going forward, the company is expected to require additional working capital borrowings. This is, however, expected to be in line with its scale of operations, and despite sequential moderation in capital structure and debt protection metrics in FY23, RSML's solvency and coverage parameters are expected to improve from FY24 onwards supported by strong operations of the company along with accretion of additional cash flows from the new unit, barring any significant dividend payouts or another significant majorly debt funded capex. The company's capital structure is also expected to get a major boost, post completion of its proposed public issuance plans although specific timelines for this remain uncertain.

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.

Key Rating Weaknesses

Scalability risk associated with brownfield debt-funded capex

RSML has fully commissioned Phase II 8,280 MT per annum cotton-synthetic mix yarn with project cost of Rs. 2,700 Mn in April 2023. The company had earlier commissioned Phase I synthetic spun yarn unit of 4,680 MT per annum capacity in February 2021 with cost of Rs. 1,400 Mn. As demand for synthetic and cotton yarn is driven by international demand-supply dynamics and are susceptible to economic cycles, there is a scalability 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 the operations in one of recent large expansions and healthy capacity utilization levels so far in FY24 mitigates the stabilization risk to some extent. Nevertheless, realization of envisaged benefit therefrom on a sustained basis shall remain crucial from credit perspective.

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 elongated to 159 days in FY23 (PY: 136 days) majorly on account of increased inventory holding, mainly pertaining to the newly commissioned synthetic-cotton mix yarn.

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 Cotton, 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 42,750 MT per year as on mid-October 2023.

Brief financials of RSML for last three years ending FY23 are given below:

For the Year ended Mid- July,	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	7,793	10,105	10,006
PBILDT Margin (%)	16.87	17.36	17.58
Overall Gearing (times)	1.05	0.82	1.59
Interest Coverage (times)	13.99	12.27	6.54
Current Ratio (times)	1.41	1.33	1.32
Total Debt/ Gross Cash Accruals (times)	2.92	2.01	4.81

A: Audited; UA: Unaudited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	3,727.57	CARE-NP A- [A Minus]
Short Term Bank Facilities	Working Capital Limits	2,375.00	CARE-NP A2+ [A Two Plus]
Short Term Bank Facilities	Non-Fund Based Limits	3,205.00	CARE-NP A2+ [A Two Plus]
Total Facilities		**9,307.57**	

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