# Arex Industries Limited

September 13, 2021

**Rating**

| Facilities/Instruments | Amount (Rs. crore) | Ratings | Rating Action |
|---|---|---|---|
| Long Term Bank Facilities | 22.54 (Reduced from 28.03) | CARE BBB; Stable (Triple B; Outlook: Stable ) | Reaffirmed |
| Long Term / Short Term Bank Facilities | 5.50 | CARE BBB; Stable / CARE A3+ (Triple B ; Outlook: Stable/ A Three Plus ) | Reaffirmed |
| **Total Bank Facilities** | **28.04 (Rs. Twenty-Eight Crore and Four Lakhs Only)** | | |

*Details of facilities in Annexure-1*

**Detailed Rationale & Key Rating Drivers**

The ratings assigned to the bank facilities of Arex Industries Limited (AIL) continue to derive strength from wide experience of its promoters along with competent management in woven labels manufacturing business, long-standing track record of AIL with well-established manufacturing setup with latest technology machines, established relationship with reputed customers, healthy profitability, moderate leverage and debt coverage indicators with adequate liquidity and favorable long-term demand scenario for woven labels.

The ratings, however, continue to remain constrained on account of its small scale of operation due to presence in product segment with a limited industry size, large working capital requirement, vulnerability of operating (PBILDT) margin to volatility in raw material prices with a limited ability to pass on the increase in cost to its customers due to competitive industry and modest return indicators, ROCE, over the past three years ended FY21 (refers to the period April 1 to March 31) due to slow ramp-up of its expanded capacities further marred by covid-19 pandemic induced disruptions.

**Rating Sensitivities**

**Positive Factors**

- Increase in capacity utilization leading to increase in scale of operations along with maintaining healthy PBILDT margin of over 20% and improvement in return indicators with ROCE at 15% on a sustained basis.
- Improvement in overall gearing below 0.50 times on a sustained basis.

**Negative Factors**

- Deterioration in its PBILDT margins below 16% and ROCE below 8% on a sustained basis.
- Deterioration in the overall gearing ratio beyond 1.50 times along with Total Debt/ PBILDT beyond 4 times on a sustained basis.

**Detailed description of the key rating drivers**

**Key Rating Strengths**

***Wide experience of promoters in woven labels manufacturing business***

The promoters of AIL have more than 30 years of experience in the woven label manufacturing business. Mr. Dinesh Bilgi, MD & CFO, is the founder promoter of AIL and looks after the day-to-day operations of the company. He is supported by his two sons, Mr. Neel Bilgi and Mr. Chirag Bilgi. Mr. Neel Bilgi is an MBA and has nearly 16 years of experience. He looks after the marketing function of the company. Mr. Chirag Bilgi is a BBA and has nearly 14 years of experience. He looks after the production and technical aspects of the company. Further, the promoters are well-supported by the second-tier management. Over the years, promoters have undertaken technological up-gradation and expansion projects to cater to increasing demand for labels from the textile industry. The management has put in place proper systems for various functions like marketing, order procurement, designing, production and other administrative functions.

***Long-standing track record of operation having established relationship with reputed customers***

AIL is one of the largest players in the organized sector in this niche segment of woven labels in the country with state-of-the-art manufacturing technology. AIL has a well-established clientele which includes most of the leading ready-made garment and home-textile manufacturers in India. Further, over the years, the company has gradually diversified its customer base. However, the revenue from its top 10 customers continues to remain high at 72% of total operating income in FY21.

***Healthy operating profitability margin along with moderate leverage***

PBILDT margin remained healthy at 16.83% during FY21, however moderated from 19.81% during FY20 owing to increased cost of raw material which could not be passed on due to covid disruptions and reduced scale. However, it is expected to improve to previous levels with recovery in demand from textiles. PBILDT margin improved to 21.36% in Q1FY22 as compared to 0.54% in Q1FY21 with increase in TOI of Rs 13.34 crore in Q1FY22 as against Rs 5.53 crore in Q1FY21. Overall gearing remained stable at 1.26 times as on March 31,2021 as against 1.25 times as on March 31,2020

***Stable demand outlook albeit competitive label industry along with linkages with cyclical textile industry***

Fortune of textile label is closely linked to the growth prospect of the Indian textile industry. AIL equally depends on garmenting and home textile for majority of its revenue. Indian Apparel (Garment) is the largest segment of the Indian Textile and Clothing Industry (IT&C); accounts for 60-65% of the total industry. Further, it is one of the largest sources of foreign exchange flow comprising 15% of total exports of the country. After restoration of normal economic activities post covid-19 pandemic induced disruptions, demand has improved from both domestic and export markets. Also, medium term demand outlook remains stable with driven by the factors like of increasing urbanization, changing lifestyle, fashion trends and consumer behavior.

However, label industry is highly fragmented and dominated by a large number of medium and small-scale unorganized players leading to high competition in the industry. Furthermore, textile is a cyclical industry and closely follows the macroeconomic business cycles. The prices of raw materials and finished goods are also determined by global demand-supply scenario. Hence, any shift in macroeconomic environment globally would have an impact on the domestic textile industry.

**Liquidity: Adequate**

Despite long working cycle, the liquidity position of the company remained moderate marked by steady cash accruals, moderate current ratio at 1.81 times as on March 31, 2021 and moderate month-end working capital utilization at 8% for the past 12 months ended May 31, 2021. Further, the company has no plans for any capex in the near future. Cash flow from operations remained positive at Rs.6.06 crore in FY21 (Rs.9.78 crore in FY20), decrease was due to lower profitability.

**Key Rating Weaknesses**

***Small scale of operations***

During FY21, total operating income (TOI) of AIL reduced by 13% over FY20 largely due to Covid-19 pandemic. The scale of operations has continued to remain small marked by TOI of Rs. 40.95 crore during FY21 and tangible net worth of Rs. 25.64 crore as on March 31, 2021, as the company is in a product segment having relatively limited market size. The small scale of operation restricts the financial flexibility of the company as well as restricts the bargaining power with its large customers.

***Under-utilization of commissioned debt funded green-field project though long-term arrangement with its leading client provides some comfort***

The utilization of total installed capacity of AIL has remained lower around 40-60% for the last four years ended FY21 due to slow ramp-up of the large sized green-field expansion project at Anjar, Dist: Kutch, Gujarat which commenced its commercial production from August 2018. This manufacturing facility of AIL is constructed on land taken on lease from Welspun India Limited (WIL: rated: CARE AA; Stable/ CARE A1+) which is adjoining to the manufacturing facility of WIL in Anjar. AIL has entered into an agreement with WIL for selling its product exclusively to WIL for a period of 10 years. WIL has agreed to off-take minimum 75% of the production capacity. Further, in case, WIL is unable to off-take minimum production quantity and AIL's manufacturing facility remains un-utilized, WIL shall reimburse all fixed costs associated with AIL's Anjar facility. This arrangement reduces the saleability risk to certain extent, although dependency on single customer increases the concentration risk.

The green-field project at Anjar, Gujarat is set-up under the textile policy of Government of Gujarat, 2012, under which, AIL is eligible for various subsidies. As articulated by the management, the total recoverable amount under ATUFS is around Rs.4-6 crore.

***Large working capital requirement apart from high fixed capital intensity resulting in modest return indicators***

AIL maintains large inventory of various coloured yarns as demand for any particular colour may arise depending on the customer requirements. Further, time for execution of order is also elongated on account of designing process involved before finalizing the order which elongates the operating cycle. Moreover, the company deals with large customers where company needs to extend higher credit period which too results in higher working capital cycle of around 80-100 days. The debtors and inventories together resulted into elongated gross operating cycle days of around 142 days during FY21. Moreover, the business of AIL requires large fixed assets investment, which, coupled with moderate utilisation of capacities, has resulted in a low fixed asset turnover ratio at close to 0.40 times in FY21.

Due to sub-optimal utilization of expanded capacities, the return indicators i.e. ROCE witnessed moderation in last three years ended FY21. The ROCE declined to 3.77% in FY21 from 12.50% during FY18. Improvement in ROCE with increase in utilisation of manufacturing capacities shall remain crucial from credit perspective.

***Vulnerability of operating margin to volatility in raw material prices and limited ability to pass on the increase in cost to its customers***

Cotton yarn and synthetic tape/ yarn are the key raw materials for AIL, the prices of which depends upon the raw cotton and crude oil prices. Over the years, the prices of both these commodities have remained highly volatile mainly due to change in global demand supply scenario. Moreover, AIL has lower bargaining power vis-à-vis its customers as the labels account for a very low value of the final garment manufactured by its customers. This coupled with presence of unorganized sector restricts company's ability to pass on fluctuations in input costs to customers.

**Analytical Approach:** Standalone

**Applicable Criteria:**

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Liquidity analysis of non-financial sector entities
Rating Methodology - Manufacturing Companies
Financial ratios - Non- Financial Sector

**About the company**

Incorporated in 1989, AIL is promoted by Mr. Dinesh Bilgi. AIL manufactures various types of woven labels of Satin and Taffeta quality in white or black warp-base, of different shapes, sizes and colors depending on the customer's requirement. The demand for these labels mainly arises from apparels/ ready-made garments and home textile segment of the textile industry along with footwear Industry. The company has total installed capacity of 27,015 million pick meters of labels as on March 31, 2021 spread across both its manufacturing facilities located in Kalol and Anjar in Gujarat. The company also has two windmills having an aggregate power generation capacity of 1.60 MW located at Porbandar, Gujarat.

*(Rs. Crore)*

| Brief Financials of AIL | FY20(A) | FY21 (A) |
|---|---|---|
| Total operating income | 47.31 | 40.95 |
| PBILDT | 9.37 | 6.89 |
| PAT | 0.87 | -1.00 |
| Overall gearing (times) | 1.25 | 1.26 |
| PBILDT Interest coverage (times) | 3.00 | 2.31 |

*A: Audited*

During Q1FY22(UA), as per the published results, AIL reported a net profit of Rs 0.79 crore on total operating income (TOI) of Rs. 13.34 crore as against net loss of Rs. 1.92 crore on a TOI of Rs 5.53 crore during Q1FY21 (UA).

**Status of non-cooperation with previous CRA:** ICRA has suspended its rating assigned to AIL vide press release dated September 26, 2016 on account of its inability to carry out a rating surveillance due to non-cooperation by the company and absence of requisite information from the company.

**Any other information:** Not Applicable

**Rating History for last three years:** Please refer Annexure-2

**Covenants of rated Instrument/facility:** Annexure-3

**Complexity level of various Instruments rated for this company:** Annexure-4

**Annexure-1: Details of Instruments/Facilities**

| Name of the Instrument | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|
| Fund-based - LT-Term Loan | - | - | March 2027 | 22.54 | CARE BBB; Stable |
| Fund-based - LT/ ST-Cash Credit | - | - | - | 5.50 | CARE BBB; Stable / CARE A3+ |

**Annexure-2: Rating History of last three years**

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating history | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2021-2022 | Date(s) & Rating(s) assigned in 2020-2021 | Date(s) & Rating(s) assigned in 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 |
| 1. | Fund-based - LT-Term Loan | LT | 22.54 | CARE BBB; Stable | - | 1)CARE BBB; Stable (06-Aug-20) | 1)CARE BBB; Stable (21-Aug-19) | 1)CARE BBB; Stable (17-Dec-18) |
| 2. | Fund-based - LT/ ST-Cash Credit | LT/ST | 5.50 | CARE BBB; Stable / CARE A3+ | - | 1)CARE BBB; Stable / CARE A3+ (06-Aug-20) | 1)CARE BBB; Stable / CARE A3+ (21-Aug-19) | 1)CARE BBB; Stable / CARE A3+ (17-Dec-18) |

**Annexure 3: Detail explanation of covenants of the rated instrument/facilities-** Not Applicable

**Annexure 4: Complexity level of various instruments rated for this company**

| Sr. No. | Name of the Instrument | Complexity Level |
|---|---|---|
| 1. | Fund-based - LT-Term Loan | Simple |
| 2. | Fund-based - LT/ ST-Cash Credit | Simple |

**Annexure 5: Bank Lender Details**

Click here to view Bank Lender Details

***Note on complexity levels of the rated instrument:*** *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

## Contact us

**Media Contact**
Mr. Mradul Mishra
Contact no.: +91-22-6837 4424
Email ID: mradul.mishra@careratings.com

**Analyst Contact**
Ms. Nikita Goyal
Contact no: +91-79-4026 5670
Email ID: nikita.goyal@careratings.com

**Relationship Contact**
Mr. Deepak Prajapati
Contact no.: +91-79-4026 5656
Email ID: deepak.prajapati@careratings.com

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