

Arex Industries Limited

August 24, 2022

Ratings

| Facilities/Instruments | Amount (₹ crore) | Rating ¹ | Rating Action |
|--|--|--|---------------|
| Long Term Bank Facilities | 16.75 (Reduced from 22.54) | 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 | 22.25 (Rs. Twenty-Two Crore and Twenty-Five Lakhs Only) | | |

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of Arex Industries Limited (AIL) continue to derive strength from vast experience of its promoters in woven labels manufacturing business, long-standing track record of operations of AIL with well-established manufacturing setup, established relationship with reputed customers, healthy profitability along with improvement in return ratio (RoCE) in FY22 (FY refers to the period April 1 to March 31), moderate capital structure as well as debt coverage indicators and its adequate liquidity.

The ratings, however, continue to remain constrained by AIL's small scale of operation due to presence in product segment with a limited industry size, moderate capacity utilization, large working capital requirement, vulnerability of profitability to volatile raw material prices with limited ability to pass on the increase in cost to its customers and its presence in a competitive industry.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- 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 – Factors that could lead to negative rating action/downgrade:

- Deterioration in its PBILDT margin 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

Vast 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 well supported by his two sons, Mr. Neel Bilgi and Mr. Chirag Bilgi, who have more than 15 years of industry experience.

Over the years, promoters have undertaken technological up-gradation and expansion projects to cater to increasing demand for labels from the textile industry.

Long-standing track record of operations and 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. The company has an established track record of operations of more than three decades.

Also, AIL has a diverse and well-established clientele which includes some of the leading ready-made garment and home-textile manufacturers in India. Revenue concentration from top 10 customers improved in FY22 and stood moderate at 55% of total operating income in FY22 (72% in FY21).

Healthy operating profit margin along with improvement in return ratios

AIL's healthy operating profit (PBILDT) margin improved by more than 400 bps y-o-y to 20.83% in FY22. The improvement was mainly on the back of increase in sale realization of its product as against raw material cost incurred during the period. With growth in scale of operations as well as better profitability, return on capital employed (RoCE) also improved to 12% in FY22 from 4% in FY21.

¹Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Moderate capital structure and debt coverage indicators

AIL's capital structure marked by its overall gearing improved to 0.82 times as on March 31, 2022 as against 1.26 times as on March 31, 2021, mainly due to prepayment of term loans in FY22 as well as increase in networth base with accretion of profit to reserves. Debt coverage indicators also improved with improvement in profitability as well as lower o/s debt and remained moderate with PBILDT interest coverage of 5.32 times (2.30 times in FY21) and total debt/ GCA of 2.79 times (7.85 times in FY21) in FY22.

Key rating weaknesses**Small scale of operations with moderate capacity utilization**

During FY22, total operating income (TOI) of AIL increased by 30% y-o-y to Rs.53.78 crore and continued to remain moderate due to presence in a product segment having relatively limited market size. The improvement in TOI was on account of recovery in demand post covid-19 pandemic resulting in increase in sales volume as well as better sales realization for its product.

The utilization of installed capacity also improved from 42% in FY21 to 56% in FY22; however, it remained moderate due to slow ramp-up of the large sized green-field expansion project at Anjar, Gujarat which commenced commercial production from August 2018. This manufacturing facility is constructed on land taken on lease from Welspun India Limited (WIL: rated: CARE AA; Stable/ CARE A1+) and is adjoining to the manufacturing facility of WIL. AIL has entered into an agreement with WIL for a period of 10 years wherein WIL has agreed to off-take minimum 75% of the production capacity of Anjar Plant. In case WIL is unable to meet the off-take requirement 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.

Large working capital requirement

AIL has to maintain large inventory of various coloured yarns as demand for any particular colour may arise depending on the customer's requirement. Further, long order execution time on account of designing process involved before finalizing the order along with credit period required to be extended to its reputed clientele further elongates the operating cycle. In FY22, AIL's operating cycle improved to 115 days from 142 days in FY21 with improvement in collection period and continued to remain elongated.

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

Synthetic tape/yarn is the key raw material for AIL, the price of which depends upon the raw cotton and crude oil prices. Over the years, the prices of this commodity 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. In addition to this, presence of unorganized sector restricts company's ability to pass on fluctuations in input costs to customers.

Presence in a competitive industry with linkages to cyclical textile industry

Label industry in which AIL operates is highly fragmented and is dominated by many medium and small-scale unorganized players leading to high competition in the industry. Moreover, fortunes of this industry are closely linked to the growth prospect of the Indian textile industry which is cyclical in nature and closely follows the macroeconomic cycle. 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); accounting for 60-65% of the total industry and is also one of the largest sources of foreign exchange inflow. Indian textile producers are presently witnessing some slowdown, especially for home textile products from major export destinations. Adding to demand challenge is the volatility in price of raw cotton, key input in home textiles. Any shift in macroeconomic environment globally would have an impact on the domestic textile industry. However, long-term demand is expected to remain stable driven by factors like increasing urbanization, changing lifestyle, fashion trends and consumer behaviour.

Liquidity: Adequate

Despite long operating cycle, the liquidity position of the company remained adequate with moderate average working capital utilization of 60% for the past 12 months ended June 2022, positive cash flow from operations and absence of any major capex plan. Cash flow from operations remained positive at Rs.10.45 crore in FY22 (Rs.6.03 crore in FY21), and improved due to better profitability.

Analytical approach: Standalone**Applicable criteria**

[Policy on default recognition](#)

[Financial Ratios – Non financial Sector](#)

[Liquidity Analysis of Non-financial sector entities](#)

[Rating Outlook and Credit Watch](#)

[Short Term Instruments](#)

[Manufacturing Companies](#)

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 colours 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, 2022 spread across both its manufacturing facilities located in Kalol and Anjar in Gujarat. The company also has two windmills having an aggregated power generation capacity of 1.60 MW located at Porbandar, Gujarat.

| Brief Financials (Rs. crore) | 31-03-2021 (A) | 31-03-2022 (A) | Q1FY23 (Prov.) |
|------------------------------|----------------|----------------|----------------|
| Total operating income | 40.92 | 53.78 | 12.05 |
| PBILDT | 6.86 | 11.20 | 2.32 |
| PAT | -1.00 | 3.70 | 0.49 |
| Overall gearing (times) | 1.26 | 0.82 | NA |
| Interest coverage (times) | 2.30 | 5.32 | 4.54 |

A: Audited, Prov: Provisional, NA: Not Available

Status of non-cooperation with previous CRA: None

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

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

Annexure-1: Details of instruments/facilities

| Name of the Instrument | ISIN | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (₹ crore) | Rating Assigned along with Rating Outlook |
|---------------------------------|------|------------------|-------------|---------------|-----------------------------|---|
| Fund-based - LT-Term Loan | | - | - | March 2027 | 16.75 | CARE BBB; Stable |
| Fund-based - LT/ ST-Cash Credit | | - | - | - | 5.50 | CARE BBB; Stable / CARE A3+ |

Annexure-2: Rating history for the last three years

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating history | | | |
|---------|--|-----------------|--------------------------------|-----------------------------|---|---|---|---|
| | | Type | Amount Outstanding (Rs. crore) | Rating | Date(s) and Rating(s) assigned in 2022-2023 | Date(s) and Rating(s) assigned in 2021-2022 | Date(s) and Rating(s) assigned in 2020-2021 | Date(s) and Rating(s) assigned in 2019-2020 |
| 1 | Fund-based - LT-Term Loan | LT | 16.75 | CARE BBB; Stable | - | 1)CARE BBB; Stable (13-Sep-21) | 1)CARE BBB; Stable (06-Aug-20) | 1)CARE BBB; Stable (21-Aug-19) |
| 2 | Fund-based - LT/ ST-Cash Credit | LT/ST* | 5.50 | CARE BBB; Stable / CARE A3+ | - | 1)CARE BBB; Stable / CARE A3+ (13-Sep-21) | 1)CARE BBB; Stable / CARE A3+ (06-Aug-20) | 1)CARE BBB; Stable / CARE A3+ (21-Aug-19) |

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: Not Applicable

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

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

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please [click here](#)

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media contact

Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact

Name: Anuja Parikh
Phone: +91-79-4026 5616
E-mail: anuja.parikh@careedge.in

Relationship contact

Name: Deepak Purshottambhai Prajapati
Phone: +91-79-4026 5656
E-mail: deepak.prajapati@careedge.in

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