Arex Industries Limited

August 06, 2020

Rating

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long term Bank Facilities	28.03 (reduced from Rs.29.82 crore)	**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	**33.53 (Rupees Thirty Three Crore and Fifty Three Lakh 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 margins despite moderation during FY20 (FY refers to the period April 01 to March 31), moderate leverage and debt coverage indicators with adequate liquidity and favourable long-term demand scenario for woven labels. Furthermore, CARE takes cognizance of various cost management initiatives being undertaken by the company such as rationalization of manpower cost by waiving off directors' remuneration along with other overhead costs so as to counter the loss of sale and challenging operating environment arising from the spread of the corona virus pandemic.

The ratings, however, continue to remain constrained on account of its small scale of operation due to presence in niche product segment, large working capital requirement, vulnerability of operating (PBILDT) margin to volatility in raw material prices, limited ability to pass on the increase in cost to its customers due to competitive industry and moderation in its return indicator, ROCE over the past two years ended FY20 due to slow ramp-up of its expanded capacities. Moreover, CARE takes cognizance of AIL's decision to avail the moratorium granted by its lenders as a Covid relief measure (as permitted by the Reserve Bank of India) for a period of six months towards the payment of interest and term debt repayment obligation.

Rating Sensitivities

Positive Factors

- Increase in capacity utilization leading to significant increase in its scale of operations while maintaining healthy PBILDT margin of around 20% and RoCE more than 15% on a sustained basis.
- Improvement in overall gearing below 0.50 times on a sustained basis.

Negative Factors

- Deterioration in its hitherto healthy PBILDT margins to below 10% on a sustained basis.
- Deterioration in the overall gearing ratio beyond 2 times along with Total Debt/ PBILDT beyond 5 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 15 years of experience. He looks after the marketing function of the company. Mr. Chirag Bilgi is a BBA and has nearly 13 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

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

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 59% of total operating income in FY20.

Healthy operating profitability margin along with moderate leverage and debt coverage indicators

Despite moderation in PBILDT margin during FY20, it continued to remain healthy PBILDT margin at 19.81%. The marginal decline in PBILDT margin during the year was primarily due to increased overhead costs associated with its new manufacturing facility at Anjar, Bhuj, Gujarat apart from increase in cost of material consumed which however was partially off-set by improved sales realization of AIL's products. The PBILDT margin was also impacted during the year due to increase in managerial remuneration by around 25% to Rs.4.43 crore in FY20 from Rs.3.34 crore in FY19. Management has indicated that they have waived off their remuneration w.e.f. April 01, 2020, till profitability and cash accruals improves to support the liquidity of the company.

The leverage of the company improved and remained moderate with an overall gearing ratio of 1.25 times as on March 31, 2020, due to the scheduled repayment of debt. Further, the debt-coverage indicators like interest coverage, total debt to GCA and total debt/PBILDT continued to remain moderate during FY20.

Favorable long-term growth prospects post effective control of Covid-19 pandemic

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. However, export is affected by duty drawback cuts under GST and on-going Covid-19 crisis. Moreover, with increasing labor cost in China, the demand is expected to shift to Bangladesh, India, Vietnam, etc.

The growth would be driven by the factors like the trend of increasing urbanization and expectation of better disposable income post the economic slowdown induced by measures to control the outbreak of the corona virus which is likely to augur well for textile apparel segment's long-term growth prospects in India. Apart from the above factors, the apparel market is likely to exhibit good growth due to expectation of increased usage of plastic money leading to impulse buying among the Indian consumers, increasing number of dual income-nuclear families, changing lifestyle, fashion trends and consumer behavior.

Key Rating Weaknesses

Small scale of operation despite gradual growth in total operating income

During FY20, total operating income (TOI) of AIL grew by 16% over FY19 largely due to increase in sales volume of woven labels and better average sales realization. The gradual growth in TOI is primarily driven by increasing sales volume supported by increase in capacities. Despite growth in TOI, the scale of operation of the company continued to remain small marked by TOI of Rs.47.31 crore during FY20 and tangible net worth of Rs.25.63 crore as on March 31, 2020. The scale of operation has remained small as the company is in a niche 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 recently 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 50-60% for the last four years ended FY20 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 interest subvention of 6% on term debt apart from refund of SGST of 2.5% on purchase of input material. Apart from state government incentive, the project is also eligible for 2% interest subvention under the central government Amended Technology Up-gradation Funds Scheme (ATUFS). The project is already approved by the central government while the same is being under consideration by State government. As articulated by the management, the total recoverable amount under ATUFS is around Rs.4 crore as on June 30, 2020. Management expects the same to be recovered in FY21 and the same shall provide cushion to profitability and liquidity.

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

AIL has to maintain 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 160 days during FY20. Moreover, the business of AIL requires large fixed assets investment and the fixed asset turnover ratio remains low at close to 0.50 times.
Due to sub-optimal utilization of expanded capacities, the return indicators i.e. ROCE witnessed moderation during FY19 and FY20. The ROCE declined to 7.56% in FY20 from 18.74% during FY17; despite healthy operating profitability margins. Further, the return indicators are expected to remain modest in near future till the time company achieves optimum utilization post effective control of Covid-19. Hence, ramp up in production and sales volume of its expanded capacity and realization of envisaged benefits shall remain critical.

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.

Impact of Covid-19 on textile sector
The Covid-19 pandemic has disturbed the demand-supply situation of the Indian textiles industry. The closure of retail stores and malls on account of lockdown situation across the nation will affect the industry's sales. On the international front, spread of Covid-19 in top export destinations such as Europe and U.S. have resulted in closure of retail stores and malls there. Even after lifting of the lockdown, gradual and delayed recovery is likely in consumer demand given the relatively discretionary nature of the textile products in the backdrop of likely economic slowdown. There may be a cascading impact on demand of other textile products including cotton yarn and fabric. Given the unfavourable demand scenario, textile firms may not utilize their full capacities or may undertake production cuts thus bringing down the overall output of textiles during FY21. In addition to this, labour disruption may also affect the total textile production as it is a labour-intensive industry. Going forward the textile industry scenario will depend on how the situation evolves in the domestic and international markets and faster return to normalcy will enable the industry to curtail the damages and improve on its growth prospects. In the medium to long term, some demand from the US and the EU markets is expected to shift (though gradually) from China to other major garment manufacturers including India to reduce dependence on China.

Liquidity: Adequate
Liquidity of the company remained adequate marked by steady cash accruals, healthy current ratio of 1.77 times as on March 31, 2020 and relatively low average fund-based working capital utilization at 50% for the past 12 months ended May 2020. During FY20, the company generated positive cash flow from operation of Rs.9.74 crore. Further, the company has been generating steady cash accruals of around Rs.6 crore over past three years ended FY20 apart from sizable undrawn working capital limits is expected to be sufficient to meet the upcoming annual term debt repayment obligation of around Rs.3-4 crore during FY21-FY22. AIL's decision to waive-off directors' remuneration during FY21 till the demand scenario improves is expected to provide cushion to its liquidity. Further, AIL has availed the moratorium granted by its lenders as a Covid relief measure (as permitted by the Reserve Bank of India) for a period of six months towards the payment of interest and term debt repayment obligation.

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
CARE's methodology for manufacturing companies
Financial ratios – Non-Financial Sector
Liquidity Analysis of Non-Financial Sector Entities

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. The company has total installed capacity of 27,015 million pick meters of labels as on March 31, 2020 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	FY19 (A)	FY20 (A)
Total operating income	40.84	47.31
PBILDT	9.68	9.37
PAT	2.52	0.87
Overall gearing (times)	1.38	1.25
PBILDT Interest coverage (times)	3.81	3.00

A: Audited

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 (Last three years): Please refer Annexure-2

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	-	-	December, 2027 ^	28.03	CARE BBB; Stable
Fund-based - LT/ ST-Cash Credit	-	-	-	5.50	CARE BBB; Stable / CARE A3+

^ The term debt was earlier scheduled to be paid off completely by March 2027 however due to extension of moratorium by lender for six months; it is now to be paid off by December 2027.

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	28.03	CARE BBB; Stable	-	1)CARE BBB; Stable (21-Aug-19)	1)CARE BBB; Stable (17-Dec-18)	1)CARE BBB; Stable (20-Dec-17)
2.	Fund-based - LT/ ST-Cash Credit	LT/ST	5.50	CARE BBB; Stable / CARE A3+	-	1)CARE BBB; Stable / CARE A3+ (21-Aug-19)	1)CARE BBB; Stable / CARE A3+ (17-Dec-18)	1)CARE BBB; Stable / CARE A3+ (20-Dec-17)

Annexure 3: 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

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.*

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