Arex Industries Limited

August 21, 2019

Ratings

Facilities*	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long term Bank Facilities	29.82 (reduced from Rs.32.24 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	**35.32 (Rupees Thirty Five Crore and Thirty Two 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 promoters 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, moderate leverage with adequate liquidity and favourable demand scenario for woven labels.

The ratings, however, continue to remain constrained on account of its small scale of operation due to the 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 saleability risk associated with the predominantly debt funded expansion project commissioned last year. The ratings also factor moderation in its return indicators i.e. ROCE and RONW over the past two years ended FY19 (FY; refers to period April 1 to March 31) on account of slow ramp-up of utilization of its expanded capacity.

The ability of AIL to significantly grow its scale of operations while maintaining its healthy profitability margins along with ramp up in production and sales volume from its expanded capacity and realization of envisaged benefits thereof resulting in improvement in its return indicators shall be the key rating sensitivities.

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 25 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 has done his Master in Business Administration and has nearly 13 years of experience. He looks after the marketing function of the company. Mr. Chirag Bilgi has done his Bachelor in Business Administration and has nearly 11 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.

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 63% of total operating income in FY19.

Healthy operating profitability margin and moderate leverage: PBILDT margin of AIL improved by 216 bps during FY19 over FY18 and stood healthy at 23.70% backed by improved sales realization of woven labels and reduced overhead costs. However, PAT margin declined during FY19 over FY18 on account of relatively high interest and depreciation cost associated with commencement of debt-funded green-field plant at Anjar (in Gujarat).

The leverage of the company, though marginally weakened, remained moderate with an overall gearing ratio of 1.38 times as on March 31, 2019. The moderation in leverage was largely on account of the drawal of term debt for funding of the new expansion facility at Anjar. Further, the debt-coverage indicators like interest coverage and total debt to GCA continued to remain moderate although they exhibited marginal deterioration during FY19 over FY18.

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

Liquidity Analysis: Liquidity of the company remained adequate marked by steady cash accruals, moderate current ratio of 1.53 times as on March 31, 2019 and relatively low average fund-based working capital utilization at 56% for the past 12 months ended June 2019. During FY19, the company generated positive cash flow from operation of Rs.5.18 crore. Further, the company has been generating steady cash accruals of Rs.6-7 crore over past three years ended FY19 which is expected to be sufficient to meet the upcoming annual term debt repayment obligation of around Rs.3.50-4.20 crore during FY20-FY22.

Favorable demand scenario; albeit competitive industry: Fortune of textile label is closely linked to the growth prospect of the Indian readymade garment/apparel industry. The growth would also be driven by the factors like rising disposable income, increased usage of plastic money leading to impulsive buying among the Indian consumers. Also, the increasing percentage of youth in the demographic mix of the country together with rising urbanization, rising mall culture, changing fashion trends and retail penetration would continue to support the growth. However, the label manufacturing sector is highly competitive and fragmented due to presence of large number of unorganized players.

Key Rating Weaknesses

Small scale of operation despite gradual growth: During FY19, total operating income (TOI) of AIL grew by 8% over FY18 largely due to increase in sales volume of printed labels and higher average sales realization of woven labels. 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.40.84 crore during FY19 and tangible net worth of Rs.25.71 crore as on March 31, 2019. The scale of operation has remained small as the company is in a niche product segment having relatively limited market size. However, small scale of operation restricts the financial flexibility of the company as well as restricts the bargaining power with its large customers.

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 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 into higher working capital cycle of around 90-110 days.

Saleability risk associated with its large sized debt funded expansion project commissioned last year: AIL concluded the construction of its large sized green-field expansion project at Anjar, Dist: Kutch, Gujarat at a total cost of Rs.37.76 crore (which was funded through the term debt of Rs.27 crore and balance through the internal accruals) and commenced its commercial production from August 2018. The new 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.

Moderation in return indicators: Due to sub-optimal utilization of expanded capacities, the return indicators i.e. ROCE and RONW witnessed moderation during FY18 and FY19. The ROCE declined to 10.28% in FY19 from 18.74% during FY17 whereas RONW declined to 10.05% in FY19 from 16.95% in FY17. Further, the return indicators are expected to remain subdued in near future till the time company achieves optimum utilization. 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.

Analytical Approach: Standalone

Applicable Criteria:

Criteria on assigning Outlook to Credit Rating
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
CARE's methodology for 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 picks meters of labels as on March 31, 2019 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	FY18 (A)	FY19 (A)
Total operating income	37.74	40.84
PBILDT	8.13	9.68
PAT	3.45	2.52
Overall gearing (times)	1.24	1.38
PBILDT Interest coverage (times)	7.43	3.81

A: Audited

During Q1FY20 (UA), as per the published results, AIL reported a net profit of Rs.0.08 crore on total operating income (TOI) of Rs.11.43 crore as against net profit of Rs.1.18 crore on a TOI of Rs.10.15 crore during Q1FY19 (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 (Last three years): Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Facilities	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	29.82	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	29.82	CARE BBB; Stable	-	1)CARE BBB; Stable (17-Dec-18)	1)CARE BBB; Stable (20-Dec-17)	1)CARE BBB; Stable (14-Dec-16)
2.	Fund-based - LT/ ST-Cash Credit	LT/ST	5.50	CARE BBB; Stable / CARE A3+	-	1)CARE BBB; Stable / CARE A3+ (17-Dec-18)	1)CARE BBB; Stable / CARE A3+ (20-Dec-17)	1)CARE BBB; Stable / CARE A3+ (14-Dec-16)

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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