Modern Insulators Limited

March 30, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long term Bank Facilities	146	CARE BBB- [Triple B Minus] (Credit watch with developing implications)	Continues on credit watch with developing implications
Short term Bank Facilities	60	CARE A3 [A Three] (Credit watch with developing implications)	Continues on credit watch with developing implications
Total Facilities	206.00 (Rupees Two Hundred and Six crore only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Modern Insulators Limited (MIL) continue to be on 'credit watch with developing implications' on account of the impending possible impact of amalgamation of Modern Denim Limited (MDL) with MIL. The scheme of amalgamation has been approved by the Board of Directors of MIL on December 04, 2019. MIL has extended unsecured loans to the loss incurring MDL which had a negative net worth as on September 30, 2019. Further, the denim industry is going through a challenging phase. As such, CARE would engage with MIL's management to gain better understanding of their plans to turnaround the operations of MDL and await the exact implications of the above amalgamation on the credit profile and cash flows of MIL. Pending greater clarity on these matters, the ratings of the bank facilities of MIL continues to be under 'credit watch with developing implications'.

The ratings of the bank facilities of MIL continue to derive strength from vast experience of its promoters along with established track record of operations in insulator business. The ratings further derive strength from its stable performance in FY19 (refers to the period from April 01 to March 31) with moderate financial risk profile marked by moderate profitability margins and debt coverage indicators, along with comfortable capital structure.

The ratings, however, continue to remain constrained on account of its elongated operating cycle, susceptibility of its profitability margins to volatility in raw material prices and probable impact of the proposed amalgamation of Modern Denim Limited on the credit profile of the merged entity due to slowdown in denim sector which is inherently cyclical in nature. The ratings are further constrained on account of the statutory auditor's qualified audit report for non-provision of income tax (including interest) of Rs.11.34 crore for FY19 in view of the proposed amalgamation.

Rating Sensitivities

Positive Factors

- Substantial increase in its scale of operations along with improvement in the profitability margins with PBILDT margin beyond 10% on a sustained basis
- Operating cycle reducing below 60 days on sustained basis with lower receivable days and better inventory management
- Stabilization of operations of terry towel division resulting in the division reporting operating as well as net profit
- Deriving significant benefits and synergies from the merger of MDL with MIL

Negative Factors

- Deterioration in PBILDT margin below 7% on sustained basis
- Overall gearing deteriorating beyond 1.25 times.

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

- Significant elongation of its operating cycle arising most likely from a stretch in its receivables and its adverse impact on its liquidity
- Any significant increase in exposure to MDL from the level as on September 30, 2019 and adverse impact of the merger on the debt coverage indicators of MIL and crystallization of the income tax liability which has not been provided in view of the proposed amalgamation

Detailed description of the key rating drivers

Key rating strengths

Experienced promoters with established track record in insulator business: The promoters of MIL have a long and established track record of around three decades in the insulator manufacturing business for transmission lines and electrical equipment. MIL manufactures wide range of Porcelain Insulators in the range of 132KV to 765 KV. The main product categories are solid core post insulators, hollow insulators, long rod insulators, railway insulators and line-post insulators. MIL has reputed clientele in its insulator segment.

Stable performance of MIL in FY19 and 9MFY20 primarily due to the insulator division: Total operating income of MIL increased from Rs.407.01 crore in FY18 to Rs.443.61 crore in FY19, registering a growth of 8.99% on y-o-y basis due to increase in sales of insulator division and terry towel division. As on October 31, 2019, the company had orders worth Rs.110.72 crore. Further, MIL reported TOI of Rs.330.55 crore in 9MFY20 as against Rs.316.06 crore in 9MFY19. PBILDT margin of the company improved by 28 bps 9.25% in FY19 due to decrease in cost of raw material consumed. Further, PAT margin improved albeit by higher 166 bps to 5.75% in FY19 due to decline in interest expenses as well provisioning of deferred tax assets. However, the terry towel division continued to report losses in FY19. Sales of the insulator division of MIL reported y-o-y growth of 7.42% to Rs.392.50 crore while sales of terry towel division reported growth of 9.20% in FY19. Further, the insulator division has reported sales of Rs.285.05 crore during 9MFY20. During 9MFY20, the PBIT margins of the insulator business remained stable at 11%.

Moderate financial risk profile of MIL (excluding impact of proposed amalgamation of MDL): The capital structure of MIL continued to remain comfortable with an overall gearing of 0.34 times as on March 31, 2019 as against 0.33 times as on March 31, 2018. Furthermore, debt coverage indicators of MIL was also moderate with total debt to GCA of 2.87 times (3.07 times as on March 31, 2018) as on March 31, 2019; improved due to higher proportionate increase in GCA vis-à-vis total debt while PBILDT interest coverage improved to 3.71 times (3.09 times in FY18) in FY19 due to lower interest expenses and higher operating profitability. MIL has extended unsecured loans to the tune of Rs.53.95 crore (Rs.49.81 crore as on March 31, 2018) as on March 31, 2019 to related parties. Further, MIL has not made provision for income tax (including interest) of Rs.11.34 crore for FY19 in view of the proposed amalgamation of MDL which has also been qualified by its statutory auditor. Upon adjusting these unsecured loans and income tax from net worth of MIL, overall gearing stood at 0.44 times as on March 31, 2019. Impact of non-provisioning of income tax on MIL's financial risk profile depends on the actual amount which may get crystallized; also greater clarity on the financial risk profile of MIL will be known once the amalgamation of MDL is given effect to.

Key Rating Weaknesses

Proposed merger with the loss-incurring Modern Denim Ltd especially when the denim industry is going through a challenging phase: MIL is in the process of filing for amalgamation of Modern Denim Ltd (MDL) with MIL for which MIL's board has given approval on December 4, 2019. MDL is in the business of manufacturing of denim fabric with its plant being situated in Ahmedabad with production capacity of 30 Million metres per annum (MMPA). During FY19, MDL reported total operating income (TOI) of Rs.75.35 crore and incurred net loss to the tune of Rs.4.46 crore. Further, during 9MFY20, MDL reported a TOI of Rs.55.55 crore and incurred net loss of Rs.3.31 crore. MDL had a negative net worth of Rs.44.58 crore with debt of Rs.68.04 crore as on March 31, 2019 which included Rs.46.81 crore of inter-corporate loan received from MIL. As of December 31, 2019 MDL's net worth stood at a negative Rs.47.91 crore.

The Indian denim fabric industry is cyclical in nature and has witnessed major slowdown at least twice over the past two decades leading to piling up of excess inventory on the back of significant capacity addition by denim fabric manufacturers and consequent pricing pressure on sales realization. Indian denim fabric manufacturing sector has more than 1.5 billion meter per year capacity. Due to continuous capacity addition, the industry is witnessing an oversupply situation leading to high competition and pricing pressure which together impacts the profitability of the industry players. Denim fabric industry has also been adversely affected by demonetization and implementation of GST. Slowdown in denim fabric industry has put pressure on margins of the industry players.

MIL's management is of the view that amalgamation of the two companies will facilitate savings in administrative and other service costs apart from savings in income tax and lead to diversification of the revenue profile of the company. However, the company has not yet submitted the copy of the Scheme of Arrangement to CARE. As such, CARE would engage with MIL's management to gain better understanding of their plans to turnaround the operations of MDL and await the exact implications of the above amalgamation on the credit profile and cash flows of MIL. Pending greater clarity on these matters, the ratings of the bank facilities of MIL have been placed under 'credit watch with developing implications'.

Elongated operating cycle: The operating cycle of MIL remained elongated at 132 days in FY19 on account of its long debtors' collection period and high inventory holding period which is inherent to the nature of business. The company maintains raw material inventory of 15 days to 70 days depending upon type of raw material. Further, the company procures imported raw material against letter of credit whereas domestic raw material is procured either on advance payment or on credit of around 30 days. MIL's customers comprise big transformer manufactures, electricity boards and railways where payment is realized between 90-140 days. As on March 31, 2019, MIL had trade receivables of Rs.91.17 crore (net of provision for doubtful debtors of Rs.2.10 crore) out of which Rs.4.89 crore were outstanding for more than six months.

Vulnerability of profitability margins to volatility in raw material prices: The prices of MIL's key raw materials for the manufacturing of insulators consist of clay, calcined alumina, metal fittings and other materials which exhibit volatility. However, the company has been generally able to partially pass on the increase in prices of key raw materials such as clay, calcined alumina and metal fittings to its customers. Also, the raw materials used for manufacturing of terry towel like cotton and polyester have exhibited fluctuation in the past and the terry towel division of MIL has been incurring losses. Thus MIL's profitability margins remain susceptible to fluctuation in raw material prices which could further increase once MDL is merged with it as the denim industry is inherently cyclical in nature.

Liquidity - Adequate: During FY19, MIL generated cash flow of Rs.23.57 crore from operating activities as against Rs.40.64 crore in FY18. Further, the company had cash and bank balance of Rs.14.59 crore as on March 31, 2019 against debt repayment obligation of Rs.0.30 crore in FY20. Furthermore, MIL's current ratio stood moderate at 1.61 times as on March 31, 2019. However, timely realization of its long-pending receivables, contraction of its operating cycle and the probable impact of the amalgamation of MDL on its cash flows will be a key monitorable for its liquidity.

Average utilization of fund based and non-fund based limits were around 80% for last 12 months ended February, 2020.

Industry Outlook – Electric Insulator business

The Government has launched various projects to strengthen the existing transmission network and increase inter-regional transfer capacity. Further, plans of adding 175 GW of renewable energy (RE) power generation capacity in India by FY2022 will require huge investments in the transmission sector. Robust grid and supply transmission network require sizable investments. Supply transmission would be vital in connecting un-electrified households in rural areas thereby improving demand for power. Grid connectivity on the other hand is vital for power-evacuation for new projects especially in the renewable segment resulting in demand for insulators.

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
Financial ratios – Non-Financial Sector
Rating Methodology - Manufacturing Companies
Rating Methodology for Cotton Textile Manufacturing

About the Company

Modern Insulators Ltd., (MIL), established in 1982 started with manufacturing Alumina Porcelain Insulators for High Voltage and Extra High Voltage Transmission Lines and electrical equipment in technical collaboration with Siemens, AG, Germany. Manufacturing facility for insulators is located in Abu Road, Rajasthan with installed capacity of 24,000 Metric Tonnes Per Annum (MTPA). The company is one of the major exporters of H.T. Porcelain Insulators from India. During FY18, MIL demerged its yarn division and merged Modern Terry Towel Ltd. Manufacturing facility of Terry Towels division is located in Ahmedabad, Gujarat. Yarn division is now demerged and floated into a separate entity named Modern Polytex Ltd. Thus, MIL now has two business segments: Insulators and Terry Towels. The proposed amalgamation of MDL with MIL is awaited. MDL's denim manufacturing facility is located in Ahmedabad, Gujarat. Mr. Sachin Ranka is the Chairman and Managing Director of MIL.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	407.01	443.61
PBILDT	36.34	41.04
PAT	16.63	25.52
Overall gearing (times)	0.32	0.33
Interest coverage (times)	3.09	3.71

A: Audited

As per its published results for 9MFY20 on the stock exchange, MIL reported a PAT of Rs.15.09 crore on a TOI of Rs.330.54 crore.

Status of non-cooperation with previous CRA: None

Any other information: Not applicable

Rating History for 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
Non-fund-based - ST-BG/LC	-	-	-	60.00	CARE A3 (Under Credit watch with Developing Implications)
Fund-based - LT-Cash Credit	-	-	-	146.00	CARE BBB- (Under Credit watch with Developing Implications)

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.	Non-fund-based - ST-BG/LC	ST	60.00	CARE A3 (Under Credit watch with Developing Implications)	1)CARE A3 (Under Credit watch with Developing Implications) (16-Dec-19) 2)CARE A3 (05-Apr-19)	1)CARE A3 (22-Mar-19) 2)CARE A3 (03-Apr-18)	-	1)CARE A3 (19-Jan-17) 2)CARE A4 (Under Credit Watch) (12-Apr-16)
2.	Fund-based - LT-Cash Credit	LT	146.00	CARE BBB- (Under Credit	1)CARE BBB- (Under Credit	1)CARE BBB-;	-	1)CARE BBB-;

				watch with Developing Implications)	watch with Developing Implications) (16-Dec-19) 2)CARE BBB-; Stable (05-Apr-19)	Stable (22-Mar-19) 2)CARE BBB-; Stable (03-Apr-18)		Stable (19-Jan-17) 2)CARE BB+ (Under Credit Watch) (12-Apr-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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