February 16, 2023

Nilons Enterprises Private Limited: Ratings downgraded to [ICRA]BB+/[ICRA]A4+; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	25.68	25.68	[ICRA]BB+; downgraded from [ICRA]BBB-; outlook revised to Stable from Negative
Cash Credit	59.50	59.50	[ICRA]BB+; downgraded from [ICRA]BBB-; outlook revised to Stable from Negative
Non Fund-Based Facilities	0.30	0.30	[ICRA]A4+; downgraded from [ICRA]A3
Interchangeable Limits	(24.75)	(24.75)	[ICRA]BB+/[ICRA]A4+; downgraded from [ICRA]BBB-/[ICRA]A3; outlook revised to Stable from Negative
Untied Limits	14.52	14.52	[ICRA]BB+/[ICRA]A4+; downgraded from [ICRA]BBB-/[ICRA]A3; outlook revised to Stable from Negative
Total	**100.00**	**100.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade of Nilons Enterprises Private Limited (NEPL/the company) factors in its stretched liquidity position owing to high dependence on working capital borrowings to meet its funding gap, on the back of subdued profits and negative free cash flows in FY2022 and 9M FY2023. After a poor performance in FY2022, while NEPL's revenues surpassed pre-Covid levels in the current fiscal (~Rs. 308 crore in 10M FY2023 against Rs. 312.9 crore in FY2022), input-cost pressures have constrained the operating margins at ~4.9% in 9M FY2023, significantly lower than the levels of 9.3-10.3% witnessed in FY2020/FY2021. This is expected to keep NEPL's leverage indicators at elevated levels in FY2023 (Total Debt/OPBITDA[1] of 4.3 times in 9M FY2023). In addition, an over reliance on short-term funds has resulted in NEPL reporting an asset-liability mismatch and subdued current ratio. ICRA understands that to shore up profit margins, the company has rolled out a 3-4% price hike in February 2023, and is implementing several cost-saving initiatives. In addition, to help ease the pressure on its liquidity position, NEPL is also looking to raise long-term debt, and has deferred all large capital spending plans. The company's ability to reduce its dependence on short-term funds and further improve the profit margins will remain critical from the credit perspective. The ratings remain constrained by the moderately high working capital intensity of the business owing to seasonality in availability of raw materials, which translates into high inventory holding requirements. Besides, NEPL's profitability remains vulnerable to the fluctuations in raw material procurement prices as well as intense competition from multiple organised as well as unorganised players in the industry, which limits its pricing flexibility.

The ratings favourably factor in the gradual pick-up in revenue in the current fiscal, led by an improvement in demand from its customers and key strategic changes made by the company. While this pick-up in sales in the recent months is directionally positive, NEPL's ability to maintain the momentum over a longer period, and further improve the profit margins remains to be seen. Further, the ratings favourably consider the established presence of the Nilon's Group and management's experience in the food industry. Further, NEPL enjoys healthy brand recognition and market position, especially in the Hindi-speaking regions of India and exhibits pan-India presence with a strong network of around 4,000 distributors. The ratings further consider NEPL's

[1] Total Debt / Operating Profit Before Interest, Tax, Depreciation and Amortisation

diversified product profile with continued focus on increasing traction of its high-margin generating products to strengthen its revenue base and profitability.

Key rating drivers and their description

Credit strengths

Gradual pick-up in revenues and earnings in FY2023; however, margins are still significantly lower than pre-Covid levels – The company reported healthy growth in revenues and earnings in the current fiscal, on the back of gradual pick-up in demand of packaged foods among consumers, following improvement in purchasing power. NEPL reported revenue of ~Rs. 308 crore in 10M FY2023 (Rs. 208 crore in 9M FY2023) while the revenue reported in FY2022 was Rs. 312.9 crore, underlining topline rebound. That said, operating margins (4.9% in 9M FY2023) are still significantly lower than pre-Covid levels of ~9-10%, as a full pass through of rising input costs is unlikely in the current year.

Long operational track record of the Nilon Group and experience of the management in the food industry – The Nilon Group (which comprised NEPL along with Group companies, Sanghavi Foods Private Limited and Sanskar Recipes Private Limited, now merged with NEPL) has a long operational track record. The experience of NEPL's management spans decades, which has helped NEPL establish its brand.

Healthy brand recognition and market position; pan-India geographical presence with strong distribution network – NEPL enjoys healthy brand recognition and market position pan-India, especially in the Hindi-speaking regions of the country. The company has a strong network of over 4,000 distributors and a direct/indirect reach to around two lakh outlets, which ensures effective market penetration and brand recognition.

Diversified product profile with focus on introducing new variants to strengthen revenue base – NEPL has a diversified product profile that includes pickles, candied fruits, chutneys, jams, ketchups and spices, among others. Such diversified product profile ensures minimal susceptibility of the company's operations to product-specific risks. The company focuses on increasing traction of its few high-margin generating products to strengthen its revenue base and profitability.

Credit challenges

Stretched liquidity – The company's liquidity remained stretched in FY2022/ 9M FY2023, owing to increased dependence on working capital borrowings to meet the funding gap due to subdued profits and negative free cash flows. An over reliance on short-term funds has resulted in NEPL reporting an asset-liability mismatch and subdued current ratio. The company's ability to reduce its dependence on short-term funds and further improve the profit margins will remain critical from the credit perspective.

Input-cost pressures have exerted pressure on operating margins leading to debt coverage indicators being suppressed in FY2023 as well – NEPL's operating margins remained subdued at 4.9% in 9M FY2023 against the negative margin reported in FY2022, being significantly lower than the previous levels (9.3-10.3% in FY2020/FY2021) due to input-cost pressures. Given the low operating margins, the debt coverage indicators remained suppressed in FY2023 as well, marked by a Total Debt/OPBITDA[2] of 4.3 times in 9M FY2023. Going forward, the company's ability to reduce its dependence on short-term funds and further improve the profit margins will remain critical from the credit perspective.

Moderately high working capital intensity – NEPL exhibits moderately high working capital intensity, as inherent in the industry. The company recorded working capital intensity of 18% in 9M FY2023, although the same had temporarily improved to 16% in FY2022. NEPL undertakes seasonal procurement of raw material, which results in high inventory levels at the year-end, thus leading to elevated working capital requirements for the company.

[2] *Total Debt / Operating Profit before Interest, Tax, Depreciation and Amortisation*

Intense competition from both organised as well as unorganised players in the food industry – NEPL operates in the food industry, which is characterised by the presence of several organised as well as unorganised players. Hence, it has to compete with numerous players in the domestic market, which limits its ability to command premium over its products. NEPL plans to focus more on high-margin products, which could strengthen its profitability and lend some comfort against the risks pertaining to intense competition from its peers.

Profitability remains vulnerable to raw material procurement prices – Given the commoditised nature of the key raw materials procured by NEPL, its profitability remains vulnerable to any fluctuations in raw material procurement prices. The company has limited scope for passing on the raw material price fluctuations to its customers, which could deteriorate its margins in case of a steep increase in raw material procurement costs.

Liquidity position: Stretched

The liquidity position of the company remains stretched with limited headroom in the working capital limits, thin operating margins, and low free cash balance of Rs. 0.6 crore as on December 31, 2022. The retained as well as free cash flows of the company are expected to remain negative in FY2023. The funding gap will be met through an increase in working capital borrowings, leading to a limited headroom (month-end utilisation stood at 94% in January 2023 and average utilisation in FY2023 remaining above 90%). ICRA, however, notes that NEPL has witnessed early signs of an uptick in margins in 9M FY2023 so far, which, if sustained over a longer period, is expected to lead to a sequential improvement in liquidity. This, along with a reduction in the working capital intensity, would remain crucial to bring back the company’s retained cash flows in the positive territory in FY2024.

Rating sensitivities

Positive factors – A significant growth in revenues and profits, leading to an improvement in its liquidity profile and credit metrics, on a sustained basis, will remain a positive rating trigger. Specific credit metrics that could lead to rating upgrade include Total Debt/OPBDITA of less than 3.0 times on a sustained basis.

Negative factors – The ratings could be downgraded, if the entity witnesses a deterioration in its revenue base and weak profitability, on a sustained basis, leading to continued pressure on the liquidity position and credit metrics.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone financial statement of the issuer

About the company

Promoted by the Jalgaon (Maharashtra)-based Sanghavi family, NEPL is involved in the manufacturing and marketing of a wide range of food products such as pickles, tooty-fruity, sauces, vermicelli, macaroni, tomato ketchup and jams, spices, instant mixes, and cooking pastes. The company markets all its products under the brand name of Nilon's. It has five manufacturing units located in Jalgaon (four units), Maharashtra and one in Dalgaon, Assam. The company has a pan-India presence for marketing its products through a strong network comprising over 4,000 distributors.

Key financial indicators

NEPL	FY2021 (Audited)	FY2022 (Audited)	9M FY2023 (Provisional)
Operating income	399.6	312.9	280.0
PAT	26.9	-32.0	0.1
OPBDIT/OI	10.3%	-5.6%	4.9%
PAT/OI	6.7%	-10.2%	0.0%
Total outside liabilities/Tangible net worth (times)	0.6	1.0	1.1
Total debt/OPBDIT (times)	0.9	-3.6	4.3
Interest coverage (times)	7.4	-3.2	2.4

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)					Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 30, 2022 (Rs. crore)	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Feb 16, 2023	May 30, 2022	-	Feb 26, 2021	Jan 31, 2020
1	**Term Loans**	Long Term	25.68	4.19	[ICRA]BB+ (Stable)	[ICRA]BBB- (Negative)	-	[ICRA]BBB (Stable)	[ICRA]BBB- (Negative)
2	**Cash Credit**	Long Term	59.50	53.61	[ICRA]BB+ (Stable)	[ICRA]BBB- (Negative)	-	[ICRA]BBB (Stable)	[ICRA]BBB- (Negative)
3	**Non Fund-based Facilities**	Short Term	0.30	-	[ICRA]A4+	[ICRA]A3	-	[ICRA]A3+	[ICRA]A3
4	**Interchangeable Limits**	Long Term / Short Term	(24.75)	-	[ICRA]BB+ (Stable)/[ICRA] A4+	[ICRA]BBB- (Negative)/[ICRA]A3	-	[ICRA]BBB (Stable)/[ICRA]A3+	-
5	**Untied Limits**	Long Term / Short Term	14.52	-	[ICRA]BB+ (Stable)/[ICRA] A4+	[ICRA]BBB- (Negative)/[ICRA]A3	-	[ICRA]BBB (Stable)/[ICRA]A3+	[ICRA]BBB- (Negative)/[ICRA]A3

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loans	Simple
Cash Credit	Simple
Non Fund-based Facilities	Very Simple
Interchangeable Limits	Simple
Untied Limits	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans**	March 2018	NA	March 2024	25.68	[ICRA]BB+ (Stable)
NA	**Cash Credit**	NA	NA	NA	59.50	[ICRA]BB+ (Stable)
NA	**Non Fund-based Facilities**	NA	NA	NA	0.30	[ICRA]A4+
NA	**Interchangeable Limits**	NA	NA	NA	(24.75)	[ICRA]BB+ (Stable)/[ICRA]A4+
NA	**Untied Limits**	NA	NA	NA	14.52	[ICRA]BB+ (Stable)/[ICRA]A4+

Source: Company

Annexure II: List of entities considered for consolidated analysis: Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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