

September 22, 2022

DKI Apparel Private Limited: Ratings reaffirmed

Summary of rating action

Instrument [^]	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term – Fund based (EPC/PCFC)	6.00	6.00	[ICRA]A3; Reaffirmed
Long term/ Short-term (Interchangeable) – Fund based (OD/WCDL/FBD/FBN)*	(6.00)	(6.00)	[ICRA]BBB- (Stable) /[ICRA]A3; Reaffirmed
Total	6.00	6.00	

[^]Instrument details are provided in Annexure-1; *Sublimit of EPC/PCFC

Rationale

While arriving at the ratings, ICRA has consolidated the financials of DKI Apparel Private Limited (DAPL) with its Group company, Defiance Knitting Industries Private Limited (DKIPL). DAPL and DKIPL share a common management. In the current fiscal, DAPL has provided a corporate guarantee of Rs. 50 crore towards the bank loans availed by DKIPL, which discontinued its apparel manufacturing operation since FY2017, for setting up a new facility for manufacturing of seamless garment in its existing plant, which is expected to be commissioned shortly.

The reaffirmation of the ratings continues to consider the promoters' extensive experience in the textile industry, a long track record of the Group in the apparel export business and its established relationship with a renowned overseas customer, leading to repeat orders since FY2017. DAPL's healthy profitability and steady revenue growth over the last three fiscals, aided by improving sales volume and realisations, strengthened its cash accruals. Its conservative capital structure and strong debt coverage metrics due to nominal debt kept the financial profile comfortable. The debt-funded capex undertaken by DKIPL will lead to an increase in borrowings and debt service obligations of the Group. Nevertheless, the consolidated capital structure and debt coverage metrics would continue to remain comfortable. The upcoming seamless garment facility of DKIPL is likely to diversify the Group's product profile and strengthen the revenue stream. However, the Group will remain exposed to the risks associated with the ongoing project, including time and cost overrun, commissioning and stabilisation as per the expected operating parameters and a ramp-up of sales post commissioning. The ratings also remain constrained by the company's exposure to high customer and geographical concentration risks as it derives revenues mainly from a single customer based out of the US. DAPL's profitability remains vulnerable to fluctuations in the prices of raw materials (mainly cotton yarn) and volatility in currency rates, given its export-oriented business, limited natural hedge and the absence of any firm hedging policy. Owing to its dependence on exports, DAPL remains exposed to any unfavourable changes in the export policies or reduction in the incentives extended by the Government, which may adversely impact its profitability. The ratings also factor in the continuous increase in the company's working capital cycle in the recent years, which may exert pressure on its cash flow from operation.

The Stable outlook on the long-term rating reflects ICRA's opinion that the Group's established operational track record in the apparel export business and long relationship with its key client would support its business positioning. The Group's ongoing capex is likely to result in product diversification and scaling up of operation. The consolidated credit metrics are also likely to remain comfortable despite the debt-funded capex.

Key rating drivers and their description

Credit strengths

Extensive experience of the promoters and established track record of the company in apparel export business – DAPL is a part of the Maharashtra-based Defiance Group. The promoters have a long experience of nearly three decades in the manufacturing of knitted fabrics and garments. DAPL has an established track record of more than a decade in manufacturing and export of apparels, mainly women's innerwear, to reputed overseas customers.

Established relationship with a reputed client resulting in repeat orders – DAPL has an established relationship with its main client, Jockey International Inc (Jockey, USA), which has a strong brand positioning. DAPL has been receiving repeat orders from Jockey consistently since FY2017, reflecting the company's adequate product quality and a strong association with the customer.

Improving cash accrual, aided by healthy profitability and steady top-line growth over the last three fiscals – DAPL's operating income (OI) consistently improved over the last three fiscals and registered a robust growth of 32% in FY2022 (provisional), supported by a significant improvement in sales volume (by 16%) and realisation (by 13%). This coupled with healthy profit margins (operating margin of 15-18% over the last three fiscals) strengthened the company's net cash accrual, which stood at Rs. 12.8 crore in FY2022 (provisional) vis-à-vis Rs. 11.3 crore in FY2021 and Rs. 9.4 crore in FY2020.

Group's foray into seamless garment manufacturing likely to diversify product profile and strengthen revenues – DAPL's Group company, DKIPL, was earlier involved in manufacturing and export of innerwear with backward integration (knitting and dyeing) and operational linkages with DAPL. DKIPL discontinued its manufacturing operations in FY2017 due to pollution-related issues but is now setting up a facility for manufacturing seamless innerwear in its existing plant. The proposed knitting and dyeing capacities of the new facility are around 5 tonnes per day and 3 tonnes per day, respectively, while the apparel making capacity is estimated at 1.5 million dozen per annum. The project is scheduled to be commissioned in October 2022. Seamless innerwear are relatively value-added items compared to the existing products of DAPL. The Group's foray into the new product line is likely to result in product diversification and strengthen its revenue stream.

Consolidated capital structure and debt coverage metrics likely to remain comfortable despite the ongoing debt-funded capex – DAPL's capital structure remained conservative due to nominal debt level (only Rs. 0.53 crore working capital borrowing as on March 31, 2022). Low debt level and healthy profitability led to strong debt coverage metrics of DAPL. The consolidated debt level and debt service obligation will increase significantly due to DKIPL's ongoing debt-funded capex for the seamless garment facility. However, the consolidated gearing is likely to remain low (below 0.5 times in FY2023) due to healthy consolidated net worth. Comfortable cash accruals compared to its debt service obligations are likely to keep the consolidated debt coverage metrics comfortable in the near-to-medium term.

Credit challenges

High customer and geographical concentration risks – DAPL derives a significant portion of its sales from a single customer (Jockey). The share of sales to Jockey declined to 87% in FY2022 from 96% in FY2021, but it still remained very high, reflecting significant client concentration risks. As the company exports apparels mainly to the US, it remains exposed to high geographical concentration risks.

Exposure to volatility in raw material prices and foreign exchange rates – DAPL procures the major raw material, grey cotton yarn, from the domestic market. Its profitability remains vulnerable to any adverse fluctuations in raw material prices, given the fixed price nature of the orders received from customers. However, such risk is mitigated to some extent by a limited lag between order receipt from clients and raw material procurement. DAPL also remains vulnerable to adverse fluctuations in foreign exchange rates, given its export-oriented business, absence of any firm hedging policy and limited natural hedge as import forms a small portion of its total purchases.

Exposure to adverse changes in the Government's export policies or incentive structures – DAPL is an export-driven company and thus receives export incentives from the Government of India, which support its operating profitability. Any unfavourable changes in export policies or reduction in incentives by the Government may adversely impact its profitability because DAPL, like other Indian apparel exporters, faces stiff price-based competition from the players of other nations.

High working capital intensity of operations – DAPL's net working capital relative to the operating income (NWC/OI) increased continuously in the recent years and stood at a high level of 41% in FY2022 (36% in FY2021). Its debtor days steadily increased to 125 in FY2021 from 42 in FY2018. Though the debtor days declined to 81 in FY2022, the NWC/OI increased because of a rise in inventory days and reduction in creditor days. The high working capital intensity of operation would increase the Group's working capital requirement, exerting pressure on the cash flow from operation as the consolidated scale of operation is likely to increase considerably in the near-to-medium term.

Risks associated with the Group's ongoing project; timeliness of project implementation and adequacy of cash flows from the new facility would remain critical from the credit perspective – The cost of DKIPL's ongoing capex, which is scheduled to be commissioned in October 2022, has been estimated at around Rs. 55 crore, out of which Rs. 40 crore is being funded by a term loan and the balance from internal sources. The internal funding for the capex is being met from DKIPL's sizeable liquid investments (around Rs. 14 crore as on March 31, 2022), mitigating the project's funding risk. However, the credit profile of the consolidated entity would remain susceptible to the risks associated with timely commissioning and stabilisation of the new facility and the Group's ability to ramp up sales from the facility post commissioning.

Liquidity position: Adequate

The Group's consolidated liquidity position is likely to remain adequate. The fund flow from operation remained comfortable at around Rs. 10 crore in FY2022. However, an increase in working capital requirement negatively impacted the cash flow from operations. This coupled with the capex of around Rs. 9 crore incurred in FY2022 for the upcoming seamless garment facility led to a negative free cash flow, on a consolidated basis. The consolidated cash flow from operation and free cash flow are likely to remain negative in FY2023 due to incremental working capital requirement with an increase in the scale of operations and the ongoing capex. The Group does not have any debt repayment obligation in FY2023. However, the term loan availed for the capex will give rise to debt repayment obligation (Rs. 40 crore to be repaid in 60 months) from H2 FY2024. Nevertheless, sizeable liquid investments of DKIPL (around Rs. 14 crore as of March 2022) would help it in meeting the internal funding requirement for the capex. This, coupled with undrawn working capital limits (Rs. 6 crore in DAPL as of June 2022) are likely to keep the consolidated liquidity position adequate.

Rating sensitivities

Positive factors – Healthy growth in the consolidated revenues and profits on a sustained basis, with diversification of clientele, may lead to an upgrade of the ratings.

Negative factors – ICRA may downgrade the ratings if the consolidated revenues and profits decline significantly. Weakening of the liquidity position due to a stretch in the working capital cycle or further capex, or a significant delay in project commissioning and ramping up of sales from the new facility may also result in ratings downgrade. Specific credit metrics, which may trigger ratings downgrade, include total debt/OPBITDA of more than 3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Textiles - Apparels Rating Approach - Consolidation
Parent/Group support	Not applicable

Consolidation/Standalone

The ratings are based on the consolidated financial statements of the rated entity along with its Group Company, Defiance Knitting Industries Private Limited (as mentioned in Annexure-II).

About the company

DAPL belongs to the Defiance Group, based in Thane, Maharashtra, and is primarily involved in textile business. The company was incorporated in 2004 and started operations in 2010. It manufactures knitted garments, primarily innerwear for women, which are mainly exported to the US market. The company's facility at Ambernath (Maharashtra) has a manufacturing capacity of around 1.8 million dozen pieces of garments per annum. DAPL has its own cutting and stitching facilities, while the knitting, dyeing and printing operations are outsourced.

Key financial indicators (audited)

DAPL	Standalone		Consolidated [^]	
	FY2021	FY2022*	FY2021	FY2022*
Operating income	70.5	92.7	71.0	93.2
PAT	9.9	11.7	9.5	11.2
OPBDIT/OI	17.9%	16.2%	16.9%	14.5%
PAT/OI	14.0%	12.7%	13.4%	12.0%
Total outside liabilities/Tangible net worth (times)	0.3	0.2	0.2	0.2
Total debt/OPBDIT (times)	0.0	0.0	0.0	0.0
Interest coverage (times)	227.6	619.4	216.4	459.9

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Provisional; [^]Estimated

Status of non-cooperation with previous CRA: Not applicable
Any other information: None
Rating history for past three years

Instrument		Type	Current rating (FY2023)		Chronology of rating history for the past 3 years			
			Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Sep 22, 2022	Aug 05, 2021	Jul 23, 2020	Sep 17, 2019
1	Fund based (EPC/PCFC)	Short term	6.00	-	[ICRA]A3	[ICRA]A3	-	-
2	Interchangeable – Fund based (OD/WCDL/FBD/FBN) [^]	Long term/short term	(6.00)	-	[ICRA]BBB-(Stable)/[ICRA]A3	[ICRA]BBB-(Stable)/[ICRA]A3	-	-
3	Fund based (Cash Credit)	Long term	-	-	-	-	[ICRA]BBB-(Stable)	[ICRA]BB+(Stable)
4	Short-term (Interchangeable) – Non-fund based (Letter of Credit)	Short term	-	-	-	-	[ICRA]A3	[ICRA]A4+

[^]Sublimit of EPC/PCFC

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund based (EPC/PCFC)	Simple
Interchangeable – Fund based (OD/WCDL/FBD/FBN)^	Simple

[^]Sublimit of EPC/PCFC

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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Fund based (EPC/PCFC)	NA	NA	NA	6.00	[ICRA]A3
-	Interchangeable – Fund based (OD/WCDL/FBD/FBN)^	NA	NA	NA	(6.00)	[ICRA]BBB- (Stable)/ [ICRA]A3

Source: Company; ^Sublimit of EPC/PCFC

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Annexure II: List of entities considered for consolidated analysis

Company Name	DAPL ownership	Consolidation Approach
Defiance Knitting Industries Private Limited	-	Full Consolidation

Source: Company; ^DAPL has provided a corporate guarantee of Rs. 50 crore for loans availed by its Group company Defiance Knitting Industries Private Limited

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1120

jayanta@icraindia.com

Kaushik Das

+91 33 7150 1104

kaushikd@icraindia.com

Sujoy Saha

+91 33 7150 1184

sujoy.saha@icraindia.com

Sovanlal Biswas

+91 33 7150 1181

sovanlal.biswas@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



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