Lahoti Overseas Ltd.

June 08, 2018

Summary of Rated Instrument:

Instrument	Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based Limit	5.00	[ICRA]BBB re-affirmed; Outlook revised to 'Negative' from 'Stable'
Short-term, Fund-based Limit	101.00	[ICRA]A3+; re-affirmed
Long-term & Short-term Unallocated Limits	1.45	[ICRA]BBB/[ICRA]A3+ re-affirmed; Outlook revised to 'Negative' from 'Stable'
Total	**107.45**	

Material Event

Lahoti Overseas Ltd. ('Lahoti' or 'the company') has announced its quarterly results on May 30, 2018. The company reported an operating income of Rs. 459.39 crore with operating profit(OPBITDA) of Rs. 10.67 crore and profit after tax (PAT) of Rs. 3.69 crore in FY2018 against operating income of Rs. 565.95 crore with OPBITDA of Rs. 16.86 crore and PAT of Rs 11.68 crore in FY2017.

Impact of the Material Event

The ratings remain unchanged at the earlier ratings of [ICRA]BBB and [ICRA]A3+ assigned to the Rs. 107.45 crore bank facilities of Lahoti. The outlook on the long-term rating has been revised to 'Negative' from 'Stable'.

Weak yarn demand with falling yarn realisations has exerted pressure on the operating performance and the company has reported a y-o-y de-growth in revenues of ~19% in FY2018. Profit levels have also remained subdued which has led to weaker debt protection metrics.

Rationale

The revision in the outlook factors in the weakness in the company's operating performance in FY2018 on account of continued weakness in export demand owing to China's subdued yarn imports, revision in export incentives on textile exports under the GST regime as well as disruption in the supply value chain because of issues related to cost and compliance of the Goods and Service Tax (GST). Consequently, the company reported a net profit of Rs. 3.69 crore on an operating income of Rs. 459.41 crore in FY2018 over a net profit of Rs. 11.68 crore with an operating income of Rs. 565.95 crore. Decline in operating profit levels has also led to weaker debt protection metrics as indicated by Total Debt/OPBDITA of 7.60 times (5.30 times as on March 31, 2017) and NCA/Total Debt of 7% (15% as on March 31, 2017) as on March 31, 2018. ICRA also notes the susceptibility of the margins to the foreign exchange rate fluctuations and also to the volatility in the prices of cotton and cotton yarn. However, with ~90% of the procurement being order-backed it mitigates the price risks to an extent.

The ratings continue to factor in the significant experience of the promoters of Lahoti in the textile business, and a satisfactory capital structure as reflected by the healthy net-worth and comfortable gearing levels of 0.74 time as on March 31, 2018. The liquidity position of the company has also remained comfortable supported by healthy liquid investments. Reduced geographic concentration risk, with the diversification of exports to other geographies, is another rating factor.

Going ahead, pick-up in global demand, fluctuation in domestic cotton yarn prices compared to international prices would continue to influence the exports growth of the company. In the absence of any major change in the product profile, profit margins are likely to remain moderate. The company's capital structure is likely to remain comfortable over the medium term in the absence of any major capex plans.

Outlook: Negative

ICRA believes Lahoti's operating performance is likely to remain subdued over the near to medium term due to weak yarn demand outlook and falling yarn realisations. Persistent weakness in demand may further exert pressure on Lahoti's performance leading to sustained de-growth in its turnover as well as profitability. The outlook may be revised to Stable if there is a pick-up in global demand and the company is able to improve its sales and profitability.

Key rating drivers

Credit strengths

- **Extensive experience of promoters in the trading of cotton yarn -** The company was set up in 1990 by the Lahoti family; and since its inception, it has been involved in trading of cotton yarn. The promoters have an extensive experience of more than three decades in the business of exporting yarn, which has enabled the company to establish its position in the exports market.
- **Financial profile characterised by strong net-worth leading to comfortable capital structure at present and healthy liquidity position-** The capital structure of the company has remained comfortable in the past three years, supported by its strong net-worth. Although the debt levels have remained high as on March 31, 2018 gearing stood comfortable at 0.73 time over a gearing of 0.81 time as on March 31, 2017 backed by the strong net worth position. The liquidity position has also remained comfortable and as on March 31, 2018 the company had a cash balance of Rs. 4.09 crore and liquid investments of Rs. 15.30 crore.
- **Diversification of exports to non-Chinese markets has minimised the geographic concentration risk** - Till FY2016, China was the major export destination accounting for ~21% of the total exports. However, in FY2017, exports to China declined to 16% of total sales over 21% in FY2016 and has further declined to 13% in FY2018 following diversification of sales to other geographies. The company has been emphasizing on exports to non-Chinese markets such as Bangladesh, South Korea, Germany, Pakistan, Tukey, and others.

Credit weaknesses

- **Weak export market conditions have exerted pressure on revenues and profitability –** Lahoti's operating income as well as profitability has been impacted in FY2018 by the continued sluggish demand in the export market amid high cotton yarn prices in the domestic market. Further, decline in duty drawback rate to 1.2% from 3%, post revision in export incentives on textile exports under the Goods and Service Tax (GST) regime has dented the operating profitability of the company and thus the coverage indicators.
- **Increase in working capital intensity due to higher inventory level -** The average shipping time of the products from the suppliers to the customers is around 10 days and the inventory reflects goods in-transit only. The working capital intensity measured by NWC/OI, has increased to 27% in FY2018 over 21% in FY2017, following higher year end sales resulting to higher goods in transit.

- **Profitability remains exposed to the highly volatile cotton yarn prices, however, majority of the procurement being backed by confirmed order mitigates the risk to a certain extent** - Yarn and fabric for trading is procured from the domestic market from the spinners of Tamil Nadu, Andhra Pradesh, Madhya Pradesh, Gujarat, Rajasthan and Haryana. The margins remain susceptible to volatility in domestic cotton yarn prices compared to international prices. Nonetheless, almost 90% of the procurement is order-backed, mitigating price fluctuation risks to an extent.
- **Margins also remain susceptible to the foreign exchange rate fluctuations, however, majority of the contracts being hedged mitigates the risk to an extent** - With the company's sales being export-oriented, the margins of the company also remain exposed to foreign exchange rate fluctuations. However, Lahoti has a policy of hedging its contracts, and at present, around 70–80% of its contracts are hedged through forward contracts.

The previous detailed rating rationale is available on the following link: Click here

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