December 27, 2019

# Kamadgiri Fashion Limited: Rating reaffirmed; Outlook revised to 'Negative'

## Summary of rating action

| Instrument | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based – Cash Credit | 50.00 | 50.00 | [ICRA]BBB reaffirmed; Outlook revised from Stable to Negative |
| Fund-based – Term Loan | 6.51 | 6.51 | [ICRA]BBB reaffirmed; Outlook revised from Stable to Negative |
| Non-fund based – Letter of Credit | 9.00 | 9.00 | [ICRA]A3+ reaffirmed |
| Unallocated limit | 3.49 | 3.49 | [ICRA]BBB/[ICRA]A3+ reaffirmed; Outlook revised from Stable to Negative |
| **Total** | **69.00** | **69.00** | |

**Instrument details are provided in Annexure-1*

## Rationale

The revision in rating outlook factors in the enduring pressure on the profitability margins of Kamadgiri Fashion Limited (KFL), arising from the escalating overhead expenses as witnessed in FY2019, coupled with sizeable costs incurred towards its new semi-operational garmenting unit in the current fiscal. This led to continued weakening of its profitability metrics and consequently its coverage and return indicators in H1 FY2020. Further, the limited bargaining power with its established customers and intense competition in the domestic market in the apparels segment restricts the company's pricing flexibility. The rating, however, continues to draw comfort from the experience of KFL's promoters in the textile industry and its strategic partnership with the Future Group. ICRA notes its position as a preferred supplier for the Future Group's leading brands in the garments segment. The rating also takes into account the company's well integrated operations across the textile value chain and the economies of scale derived from the company's presence in greige fabric, suiting and shirting fabric and readymade garments.

The Negative outlook on the [ICRA]BBB rating reflects ICRA's opinion that downward pressure on the rating could arise if KFL's scale and profitability margins as well as return indicators show continued deterioration with further weakening of coverage indicators.

## Key rating drivers

## Credit strengths

**Extensive experience of the promoters in the textile industry -** The promoter, chairman and managing director, Mr. Pradip Kumar Goenka, has been operating in the textile sector since 1978. Under his guidance, the company has evolved into a fully-integrated unit, launching its in-house 'True Value' brand for suitings and shirtings in 2005 and taking over Stripes Apparels Ltd. (SAL), a Future Group entity, in 2008. It has built established relationships with reputed brands rendering a wide coverage in terms of market presence.

**Strategic partnership with the Future Group; preferred manufacturer of leading brands in the garments segment -** Over 30% of the revenues of KFL is driven by the Future Group. KFL has entered into a strategic partnership with the Group, whereby the company will be the preferred supplier for the Group's private brands retailed across its network. The partnership also provides access and leverage for KFL to Future Group's extensive knowledge and infrastructure in areas like gathering customer insights, manpower training, logistics, supply chain management and brand development. Besides being a significant revenue contributor, the Future Group also holds a stake through its Group companies—namely Suhani Trading and Investment Consultants Private Limited (erstwhile PIL Industries Limited; 28.03%) and Surplus Finvest Pvt. Ltd. (9.69%)—as of March 2019. KFL is a preferred supplier for reputed apparel brands of the Future Group, which are sold through its chain of retail stores, both the lifestyle and value segments across India.

**Economies from integrated operations with presence in greige fabric, suiting and shirting fabric and readymade garments -** KFL has five manufacturing facilities - two weaving units at Umbergaon, Gujarat and two garment units at Tarapur, Maharashtra and a new garmenting unit in Sanjan, Gujarat. The two units at Tarapur are dedicated to manufacture men's formal and casual shirts. The company derives economies of scale from its integrated operations in greige fabric, suitings and shirtings, and readymade garment manufacturing segments. The company's capacity utilisation remained mature at ~89% in its garmenting and weaving unit in FY2019. Further, the company launched 'Risque', its in-house men's casual shirt brand in FY2019. This is expected to enable the company to improve its margin and increase revenue generation from the garments segment in same capacities. KFL has also recently launched its women's wear segment, under the division 'Turquoise' It plans to leverage its fabric manufacturing capacity for the production of innovative fabrics for women's garments, which will go a long way in creating its own women's wear brand in the future.

## Credit challenges

**Persistent pressure on company's profitability margins arising from the sizable costs incurred towards its new semi-operational garmenting unit along with other escalating overhead expenses –** The operating margins declined to 5.80% in FY2019 from 6.27% in FY2018 with the rise in employee and other manufacturing expenses. While the dip in operating profitability in H1 FY2020 was primarily due to sizable expenses amounting to Rs. 0.75-1.00 crore incurred towards its new garmenting unit, which is yet to generate remunerative returns. Garmenting job-works will be now taken up in its own newly operational facility, which will facilitate the reduction of outsourced job work costs, thereby improving its margins. This will be further supported by interest subsidy and employee payroll assistance from the State Government of Gujarat. At the net level, the interest expense on external borrowings continues to subdue the net margins.

**Continued deterioration in return and coverage indicators arising from steady weakening of operating profitability margins -** The coverage indicators have shown continued deterioration from declining operating profitability with gearing increasing to 1.32x in H1 FY2020 from 1.13x in FY2019, interest coverage reducing to 1.91x in H1 FY2020 from 2.55x in FY2019. The increase in interest expenses due to new term loan availed and lease liability from the new capacity expansion have also lead to weakening of coverage metrics.

**Limited bargaining power and intense competition in the domestic market reduces pricing flexibility amid volatile input costs -** The raw material cost is the single largest component of the cost structure of a textile player. KFL has agreements with leading brands for contract manufacturing, which is driven by established relationships with its clients. However, the large textile chains are usually the price takers, leaving KFL with limited bargaining power. Further, the pricing of the finished garment is based on the fabric and amount of value addition charges in the nature of cutting, dyeing, stitching, embroidery and final packing. The same are also subjected to a periodic price revision policy with KFL's customers, which partially mitigate the raw material price risk.

**Intense competition from a large number of organised and unorganised players -** Intense competition from local as well as global players in the industry, catering to the mid and high-end category, has kept the firm's bargaining power weak. The readymade garment industry is highly fragmented in nature due to the policy promotion of the small-scale sector by the Government over the decades. Despite growth in the organised readymade garment sector, it continues to be dominated by small-scale units with limited production capacity, since the inflexible labour policies do not favour large players. This leads to intense competition in the field, leading to limited pricing flexibility. KFL continues to face selling price pressures.

## Liquidity position: Adequate

KFL's liquidity is **adequate** given the undrawn working capital limit of Rs. 7.60 crore as on October 31, 2019 and buffer from Rs. 0.97 crore of cash and liquid investments as on September 30, 2019. KFL plans to incur Rs. 11.20 crore of capex in FY2020, funded through a term loan of Rs. 8.40 crore. The scheduled repayment obligation for term loans is ~Rs. 2-3 crore with a favourable moratorium period. The repayments will commence from FY2021, which is expected to be supported by sufficient net cash accruals.

## Rating sensitivities

**Positive triggers –** ICRA could upgrade the rating if there is significant improvemet in KFL's scale and profitability along with ROCE above 13% on a sustained basis.

**Negative triggers** – Downward pressure on the rating could arise if KFL's scale and profitability margins show sustained deterioration and if the ROCE falls below 10% with further weakening of coverage indicators.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology<br>Rating Methodology for Entities in the Indian Textile Industry - Apparels<br>Rating Methodology for Entities in the Indian Textile Industry – Fabric Making |
| Parent/Group Support | - |
| Consolidation/Standalone | Standalone approach |

## About the company

Incorporated in 1987, KFL (erstwhile Kamadgiri Synthetics Ltd. or KSL) has evolved from a fabric weaver/manufacturer to a full chain textile unit. Consequently, it was renamed as Kamadgiri Fashion Ltd. w.e.f. October 2010. At present, it weaves and manufactures fabrics (in-house) and ready-to-wear garments (contract manufacturing) such as formal shirts, casual shirts and bottom wear for reputed brands. It also offers customised uniform tailoring services. Based in Andheri, Mumbai, the firm operates weaving and garmenting units in Maharashtra and Gujarat. The shares of KFL were listed on the Bombay Stock Exchange in 1993. The company is promoted by Mr. Pradip Kumar Goenka and his family. Mr. Goenka has more than three decades of experience in the textile industry.

In FY2019, the company reported a net profit of Rs. 4.71 crore on an operating income of Rs. 318.61 crore, as compared to a net profit of Rs. 6.51 crore on an OI of Rs. 330.98 crore in the previous fiscal.

## Key financial indicators

| | FY2018 | FY2019 | H1 FY2020 |
|---|---|---|---|
| Operating Income (Rs. crore) | 330.98 | 318.61 | 156.62 |
| PAT (Rs. crore) | 6.51 | 4.71 | 0.04 |
| OPBDIT/ OI (%) | 6.27% | 5.80% | 4.03% |
| RoCE (%) | 19.71% | 15.51% | 7.09% |
| | | | |
| Total Debt/ TNW (times) | 1.33 | 1.13 | 1.32 |
| Total Debt/ OPBDIT (times) | 2.59 | 2.68 | 4.45 |
| Interest Coverage (times) | 2.89 | 2.55 | 1.91 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| | Instrument | Current Rating (FY2020) | | | | Rating History for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Rating 27-Dec-2019 | FY2019 7-Jan-2019 | FY2018 3-Nov-2017 | FY2018 10-Jan-2017 |
| 1 | Cash Credit | Long Term | 50.00 | - | [ICRA]BBB (Negative) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB- (Stable) |
| 2 | Term Loan | Long Term | 6.51 | 3.82 | [ICRA]BBB (Negative) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB- (Stable) |
| 3 | Letter of Credit | Short term | 9.00 | - | [ICRA]A3+ | [ICRA]A3+ | [ICRA]A3+ | [ICRA]A3 |
| 4 | Unallocated limit | Long Term/ Short term | 3.49 | - | [ICRA]BBB (Negative)/ [ICRA]A3+ | [ICRA]BBB (Stable)/ [ICRA]A3+ | [ICRA]BBB (Stable)/ [ICRA]A3+ | [ICRA]BBB- (Stable)/ [ICRA]A3 |

## Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website click here

## Annexure-1: Instrument Details

| ISIN No | Instrument Name | Date of Issuance/ Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Cash Credit | - | - | - | 50.00 | [ICRA]BBB (Negative) |
| NA | Term Loan | FY2016-FY2018 | 10.95% | FY2022 | 6.51 | [ICRA]BBB (Negative) |
| NA | Letter of Credit | - | - | - | 9.00 | [ICRA]A3+ |
| NA | Unallocated limit | - | - | - | 3.49 | [ICRA]BBB (Negative)/ [ICRA]A3+ |

*Source: KFL*

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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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