February 20, 2020

Kamadgiri Fashion Limited – Update on Material Event; ratings downgraded to [ICRA]BBB- (Negative)/[ICRA]A3

Summary of rated instrument

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

**Instrument details are provided in Annexure-1*

Material Event

Kamadgiri Fashion Limited (KFL) has announced its quarterly results on February 11, 2020. The company reported an operating income of Rs. 62.73 crore with operating profit (OPBDITA) of Rs. 0.72 crore and net loss of Rs. 2.10 crore in Q3 FY2020 against operating income of Rs. 87.20 crore with OPBDITA of Rs. 3.70 crore and net profit of Rs. 0.20 crore in Q2 FY2020 and operating income of Rs. 81.47 crore with operating profit of Rs. 4.60 crore and net profit of Rs. 1.08 crore in Q3 FY2019.

Impact of the Material Event

ICRA has downgraded the long-term rating to [ICRA]BBB- (pronounced ICRA triple B minus) from [ICRA]BBB (pronounced ICRA triple B) and has also downgraded the short-term rating to [ICRA]A3 (pronounced ICRA A three) from [ICRA]A3+ (pronounced ICRA A three plus) for the Rs. 69.00 crore bank lines of the company. The outlook on the long-term rating continues to be Negative.

Rationale

The revision in rating factors in the higher than anticipated deterioration in performance with cash losses reported in Q3 FY2020 due to lower sales driven by subdued demand conditions leading to under absorption of costs which is likely put pressure on the full year performance and underperform as compared to earlier estimated by ICRA. There has been a significant decline in Q-o-Q and Y-o-Y performance. The company's operating income in Q3FY2020 was lower by 28% in Q-o-Q and lower by 23% in comparison to Q3 FY2019. Its operating margin in Q3FY20 has declined to 1.14% from 4.30% in Q2FY20 mainly on account of lower sales leading to lower absorption of costs coupled with sizeable costs incurred towards its new semi-operational garmenting unit in the current fiscal. The ROCE weakened to 3.12% as on 9M FY2020 as compared to 15.51% in FY2019. The interest coverage and liquidity position of the company has also weakened with interest coverage in Q3FY2020 has deteriorated to 0.41x from 2.20x in Q2FY2020 and near to full utilization of working capital limits with marginal buffer in the form of cash and cash equivalents. 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 the likely pressure on margins on account of continued subdued demand conditions, which is like to delay the recovery process and may impact the profitability margins, coverage indicators as well as return indicators in the full year.

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

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.

Moderate capital structure and efficiency in working capital management - The debt profile of the company mainly consists working capital debt of Rs. 45.02 crore, term loan and vehicle loans of Rs. 5.15 crore and lease liability amounting to Rs. 13.26 crore as on December 31, 2019. Though the net-worth position weakened from Rs. 43.88 crore in FY2019 to Rs. 40.40 crore in 9M FY2020, the gearing stood at 1.57x as on December 31, 2019. The working capital intensity of the company continues to remain comfortable as depicted by NWC/OI of ~19%.

Credit challenges

Revenue de-growth in FY2019 and 9MFY2020, losses incurred in 9M FY2020 due to higher overheads and under absorption of fixed costs– The OI of KFL declined from Rs. 330.98 crore in FY2018 to Rs. 318.61 crore in FY2019. In 9M FY2020, KFL's operating income witnessed de-growth of 6% at Rs. 219.41 crore in comparison to Rs. 232.32 crore in 9M FY2019. Pressures on the profitability margins persist as demonstrated by operating margins declining to 3.25% in 9MFY2020 from 5.80% in FY2019 from 6.27% in FY2018 with the rise in employee and other manufacturing expenses and pre-operative expenses on capex. Further, with historically (past 7 quarters) lower sales recorded in Q3FY2020 and higher employee costs with upward revision in the employer's contribution towards Employee Provident Fund which had to be paid retrospectively for the period April to December 2019, the company incurred net losses in the same quarter. For 9MFY2020, operating margin stood lower at 3.25% in comparison to 5.48% in 9M FY2019 which trailed to a net loss of 0.94% against net margin of 1.20% in 9M FYFY2019 along with weakening of the company's net cash accruals position. Accordingly, the interest coverage in 9M FY2020 has weakened to 1.42x from 2.48x in 9M FY2019. The ROCE weakened to 3.12% as on 9M FY2020 as compared to 15.51% in FY2019.

Continuing high reliance on working capital borrowings– The average working capital utilization in the past 2 quarters has remained high at 90% peaking in the last three months with a maximum utilization level of 97%. Due to weakening of liquidity profile and weakened profitability and cash accruals, there has been higher reliance on external borrowings. Due to sluggish sales, average inventory turnaround stood at 87 days in 9M FY2020 higher than 77 days in FY2019.

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: Stretched

KFL's liquidity is **stretched** given the limited buffer in undrawn working capital limit, wherein the utilization level for last 6 months stood at a high of 97% and limited buffer available in the form of cash and liquid investments as on December 31, 2020. KFL has an ongoing capex plan to the tune of Rs. 11.20 crore in FY2020, funded through a term loan of Rs. 8.40 crore. The scheduled repayment obligation for term loans is ~Rs. 2-3 crore. The repayments on the new term loan (Rs.

1.68 crore annually) will commence in FY2021. The sufficiency of the cash accruals, through turnaround of operations and better profitability remains critical for improvement in the liquidity profile.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Stable if there is significant improvement in KFL's scale, profitability and its liquidity profile alongwith 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. Delay in turn around of operations leads to further weakening of liquidity position and coverage indicators and its ROCE remains subdued. Inability to generate commensurate returns from the capex incurred.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Indian Textile Industry - Apparels 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 9M FY2020, the company reported a net loss of Rs. 2.05 crore on an operating income of Rs. 219.41 crore, as compared to a net profit of Rs. 0.04 crore on an OI of Rs. 318.61 crore in FY2019.

Key financial indicators

	FY2018	FY2019	9M FY2020*
Operating Income (Rs. crore)	330.98	318.61	219.41
PAT (Rs. crore)	6.51	4.71	-2.05
OPBDIT/ OI (%)	6.27%	5.80%	3.25%
RoCE (%)	19.71%	15.51%	3.12%
Total Debt/ TNW (times)	1.33	1.13	1.57
Total Debt/ OPBDIT (times)	2.59	2.68	6.67
Interest Coverage (times)	2.89	2.55	1.42

**Unaudited*

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)	Current Rating 20-Feb-2020	Earlier 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 (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB- (Stable)
2	Term Loan	Long Term	6.51	4.37*	[ICRA]BBB- (Negative)	[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+	[ICRA]A3
4	Unallocated limit	Long Term/ Short term	3.49	-	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB- (Stable)/ [ICRA]A3

*as on December 31, 2019

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 www.icra.in

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:

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