April 22, 2020

Kamadgiri Fashion Limited: Ratings downgraded to [ICRA]BB+ (Negative)/[ICRA]A4+

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]BB+ (Negative) downgraded from [ICRA]BBB- (Negative)
Fund-based – Term Loan	6.51	10.00	[ICRA]BB+ (Negative) downgraded from [ICRA]BBB- (Negative)
Non-fund based – Letter of Credit	9.00	9.00	[ICRA]A4+ downgraded from [ICRA]A3
Unallocated limit	3.49	0.00	-
Total	**69.00**	**69.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in ratings of Kamadgiri Fashion Limited (KFL) factors in the anticipated weakening of demand outlook for domestic apparel and fabric players like KFL in FY2021 owing to the nationwide lockdown due to the COVID-19 pandemic. The pandemic, in turn, is expected to lead to disruption of production and exert pricing pressures, adversely impacting KFL's financial profile. Besides under-absorption of costs, the debt repayments in FY2021 are expected to keep liquidity profile under stress. ICRA notes that for 9M FY2020 the company has reported losses because of lower sales leading to under absorption of costs. With large format stores, the key customers of KFL, temporarily shutting down operations during lockdown from mid-March 2020, the earlier expectations of top line growth and profitability will be difficult to achieve for FY2020. Further in FY2021, the sales offtake and recovery of receivables from the garment segment, which is largely contingent on Future Group, is likely to be impacted by the virus outbreak and would remain a key monitorable.

The ratings, however, continue to draw comfort from the experience of KFL's promoters in the textile industry and its strategic partnership with the Future Group. The ratings also take 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]BB+ rating reflects the expectation of a weak operating performance, at least over the next few quarters with likely pressure on sales and margins on account of the COVID-19 induced lockdown. ICRA believes an extended period for revival of demand conditions is likely to delay the recovery process and impact the financial performance. ICRA, however, will continue to closely monitor the developments related to restart of production and improvement in KFL's liquidity profile through judicious management of fixed costs.

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 - KFL derived over 30% of its revenues from Future Group in FY2019. It has entered into a strategic partnership with the Group, wherein the company is the preferred supplier for the Group's private brands across the latter's network of retail stores, both the lifestyle and value segments, in India. The partnership also provides KFL with access to the Future Group's extensive knowledge and infrastructure in areas like customer insights, manpower training, logistics, supply chain management and brand development.

Economies from integrated operations with presence in greige fabric, suiting and shirtings, and readymade garments - KFL has five manufacturing facilities—two weaving units at Umbergaon (Gujarat), two garment units at Tarapur (Maharashtra), and a new garmenting unit at Sanjan (Gujarat). The two Tarapur units are dedicated to manufacturing 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. KFL'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 its 'Turquoise' division. 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

Revenue degrowth in 9M FY2020 with losses due to under absorption of costs; muted top line performance anticipated for FY2021 amid nationwide lockdown led by COVID-19 from March 2020 onwards – In 9M FY2020, KFL's operating income witnessed degrowth of 6% at Rs. 219.41 crore in comparison to Rs. 232.32 crore in 9M FY2019. For 9M FY2020, operating margin stood lower at 3.25% over 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. Owing to the nation-wide lockdown due to COVID-19, ICRA's earlier expectations of FY2020 and FY2021, primarily top line growth and margins, may be difficult to achieve due to the production disruptions in Q1 FY2021. Also, the impact of COVID-19 on the credit profile of its key customers in Future Group is expected to affect operations of the garment segment in the near term.

Weak domestic demand outlook in FY2021 given the business lockdown in Q1 FY2021 following COVID-19 outbreak to adversely impact financial risk profile – With a prolonged impact on demand in the overall textile sector, revival of sales in FY2021 is going to be slow and extended on account of the discretionary nature of KFL's product. Being sensitive to consumer discretionary spending and supply chain disruptions, the Indian apparel sector's performance is expected to be adversely affected by the rapid spread of the pandemic across countries, including India. On the supply side as well, social distancing and lockdowns have disrupted production in recent months, given the non-essential and labour-intensive nature of operations. In addition, logistical issues have affected shipment of finished stock ready for dispatch.

With the lockdown announced by the Government of India from March 25, 2020 onwards to combat the spread of the virus, domestic apparel sales have come to a complete halt. Even as uncertainty on the duration of the lockdown remains, ICRA expects a prolonged impact on demand in the sector, with recovery likely to be gradual over several months and likely consumer skepticism to step out, which may keep footfalls subdued in offline retail, even after the official lockdown is lifted.

Sizeable debt repayments in FY2021 to keep liquidity profile under stress - With cash flows expected to be impacted in Q1 FY2021, KFL has availed for moratorium on interest and principal payments provided by the regulator at the end of March 2020. Going forward, meeting repayments from June 2020 will largely be dependent on recovery of receivables as well as buffer available in cash and undrawn limits through judicious management of fixed costs.

Continuing high reliance on working capital borrowings– The reliance on working capital utilisation is high with inventory holding of ~3 months given different range of garments and fabric. Due to sluggish sales, average inventory turnaround stood at 87 days in 9M FY2020 higher than 77 days in FY2019. The working capital utilisation was high till January 2020 and is expected to go up by the end of March 2020 on account of the lockdown leading to inventory pile up

Limited bargaining power and intense competition in the domestic market reduces pricing flexibility amid volatile input costs - Raw material cost is the single largest cost component 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 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 average utilisation level was 91% for the last 12-month period ending on January 31, 2020, and limited buffer available in the form of cash and liquid investments as on December 31, 2020. KFL had a capex plan to the tune of Rs. 11.20 crore in FY2020, funded through a term loan of Rs. 8.40 crore with Rs. 3.50 crore disbursed till date. The scheduled repayment obligation for term loans is ~Rs. 2-3 crore for the next three fiscals. The repayments on the new term loan 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 faster than anticipated resumption of operations, leading to improvement in sales and profitability, and generation of positive cash flows.

Negative triggers – Downward pressure on the rating could arise if there is a delay in receipt of receivables leading to further weakening of the liquidity position. Any inadequacy of cash flows amid business interruptions from the COVID-19 outbreak, to timely meet debt servicing obligations will also be a negative trigger.

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 an integrated textile unit. Consequently, it was renamed as Kamadgiri Fashion Limited w.e.f. October 2010. KFL 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. Future Group holds a stake (not under promoter and Promoter Group holding) in KFL through its Group companies—namely Future Corporate Resources Private Limited (erstwhile Suhani Trading and Investment Consultants Private Limited; 28.03%) and Surplus Finvest Private Limited (9.69%)—as of December 2019.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 Outside Liabilities/Tangible Net Worth (times)	2.92	2.44	2.92
Total Debt/ OPBDIT (times)	2.59	2.68	6.67
Interest Coverage (times)	2.89	2.55	1.42
DSCR	1.81	1.44	1.15

**Unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating 22-Apr-2020	Earlier Rating 20-Feb-2020	Rating History for the past 3 years FY2020 27-Dec-2019	FY2019 7-Jan-2019	FY2018 3-Nov-2017
1	Cash Credit	Long Term	50.00	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Term Loan	Long Term	10.00	4.37*	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
3	Letter of Credit	Short term	9.00	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+
4	Unallocated limit	Long Term/ Short term	-	-	-	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [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 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]BB+ (Negative)
NA	Term Loan	FY2016-FY2018	11.95%	FY2024	10.00	[ICRA]BB+ (Negative)
NA	Letter of Credit	-	-	-	9.00	[ICRA]A4+

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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