September 17, 2021

Jeans Knit 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/ Cash Credit	70.00	60.00	[ICRA]A2; reaffirmed
Long-term - Fund Based TL	129.57	54.57	[ICRA]BBB+ (Stable); reaffirmed
Short-term - Unallocated facilities	25.43	15.43	[ICRA]A2; reaffirmed
Total	**225.00**	**130.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation reflects the expected steady growth in revenues and earnings of Jeans Knit Private Limited (JKPL) in the near term, driven by improved demand conditions, and consequent improvement in credit metrics post the deterioration in performance witnessed in FY2020 and FY2021. JKPL's revenues are expected to grow by more than 15% in FY2022, backed by steady receipt of orders from its key customers. Further, its operating margins are likely to recover to the steady-state levels of 15%, with increasing focus on improving its product portfolio and better operating efficiencies. JKPL's performance over the past two fiscals were adversely impacted due to demand slowdown and loss of business from a key customer and consequent higher discounts extended to liquidate stock, adversely impacting margins. Lower earnings and high debt levels resulted in modest credit metrics in the recent fiscals. While dependence on external debt is because of the working capital requirements in the business and long-term debt drawn towards capital expenditure incurred in recent fiscals, debt levels have reduced from the peak of FY2020 on the back of reduction in scope of expansion. Further, credit metrics are expected to improve with an anticipated growth in earnings in the coming fiscals, which would be utilised towards reducing external debt levels and no expansion planned. Key metrics including interest coverage, debt service coverage ratio (DSCR) and total debt to operating profits (TD/OPBDITA) are expected to improve to around 7 times, 1.5 times and 2 times, respectively in FY2022 (and further improve to around 8.5 times, 1.7 times and 1.5 times, respectively in FY2023). The ratings also consider the established presence of the company in the denim apparel export segment and long relationships enjoyed with reputed large apparel retailers in key export markets, as reflected in repeat businesses generated over the years. The ratings continue to factor in the high customer concentration risks, working capital intensive nature of operations, modest return indicators and susceptibility of earnings to fluctuations in raw material prices and foreign exchange rates given the limited pricing flexibility in the business due to intense competition. ICRA also notes the high contingent liabilities outstanding over the past decade of more than Rs. 160 crore (pertaining to the dispute on disallowances under Section 10B of the IT Act) has been favourable on the company.

The Stable outlook reflects ICRA's opinion that JKPL's performance will improve, benefiting from its vast track record of operations, established relationships with large apparel retailers, improving demand scenario and comfortable capitalisation levels.

Key rating drivers and their description

Credit strengths

Established presence in apparel export industry – JKPL is a part of the FFI Global Group, which has more than three decades of experience in the apparel exports industry. JKPL's promoter, Mr. Anupam Kothari, is a textile engineer and has an extensive experience in apparel manufacturing and exports, which supported the company in developing good relationships with large apparel retailers across Europe and the US markets. JKPL has fostered relationships with leading global apparel retailers, establishing a strong client base including G-Star (The Netherlands), Smartwool, NAPA etc. The company's client base has been providing repeat business on a sustained basis, reflecting favourably on its track record and competitive position in the sector.

Comfortable capital structure – Despite an increase in the long-term debt levels (to fund the expansion undertaken) and net losses incurred in the recent fiscals, JKPL's capital structure remained at comfortable levels. The gearing and total outside liabilities to the tangible net worth stood at 0.2 times and 0.3 times, respectively in FY2021. While its credit metrics had been adversely impacted in FY2020 and FY2021, with the expected growth in earnings in the coming quarters, key metrics including DSCR and net debt to operating profits are likely to improve to around 1.5 times and 2 times, respectively.

Credit challenges

High working capital intensity and modest return metrics – JKPL's return on capital employed stood at sub-optimal levels in the recent fiscals on the back of low-capacity utilisation and high working capital requirements in the business. The working capital intensity remained high at more than 80%, owing to high inventory levels (attributed to import requirements and wide product range) and credit period enjoyed by customers, and is expected to remain high over the medium term. While leverage indicators are expected to improve gradually with growth in revenues and earnings, return indicators are likely to remain at modest levels at around 5% in FY2022 and FY2023.

High customer concentration – JKPL derives its revenues from the European (~60% of total sales in FY2021) and the US markets (around 20% of total sales in FY2021). Its top five customers contributed more than 90% to the revenues, exposing JKPL's earnings and receivables to the performance of these clients. High client concentration had adversely impacted the company's performance in the recent fiscals, with loss of business from a key customer. With addition of two new customers (contributing 20% to the revenues in FY2021), JKPL's revenues are likely to register a steady growth over the medium term.

Earnings exposed to fluctuations in raw material prices and foreign exchange rates – Similar to other apparel exporters, the company's profitability is susceptible to adverse movement in raw material prices and foreign exchange rates, given its export-driven revenue profile and intense competition from other key exporting nations, which limits its pricing flexibility. A significant appreciation in prices of raw materials or unfavourable currency movements can adversely impact its revenues and profitability as well as its competitiveness against other exporting countries. However, benefits of partial natural hedging, given the reliance on import of raw materials and use of foreign currency borrowings mitigate the risk to some extent.

Liquidity position: Adequate

JKPL's liquidity position is expected to remain adequate, supported by growth in earnings from operations, adequate unutilised lines of credit and free cash reserves enjoyed by the company. JKPL's cash buffer, including unutilised lines and free cash reserves, stood at around Rs. 28 crore as on July 31, 2021. The average utilisation of its working capital facilities stood at around 61% over the last 12 months ended July 2021. Against the proposed capital expenditure of around Rs. 2 crore and fixed debt repayment obligations of ~Rs. 12 crore in FY2022, JKPL is expected to generate cash accruals of more than Rs. 30 crore. These along with the cash buffer, lend comfort to the liquidity profile to meet any incremental working capital requirements.

Rating sensitivities

Positive factors – The ratings could be upgraded if there is a healthy growth in its scale of operations and earnings, which would help improve its credit metrics and return indicators. Further, JKPL's ability to diversify its presence across clients and geographies, together with efficient working capital management, would be positive rating triggers.

Negative factors – Pressure on the ratings could arise if JKPL is unable to improve its revenues and profitability on a sustained basis in the coming quarters, which in turn support improvement in credit metrics and return indicators. Additionally, JKPL's ratings would be under pressure upon any further stretch in the working capital cycle, adversely impacting its capital structure and liquidity position, would also be a negative trigger. Specifically, its inability to improve DSCR to more than 1.5 times and Total Debt/OPBIDTA to less than 2.5 times on a sustained basis, could result in ratings downgrade.

Further, the company faces prepayment risk given the possibility of debt acceleration upon the breach of covenants, including rating-linked covenants. In case of a failure to meet the covenants, if JKPL is unable to get waivers from the lenders or the lenders do not provide adequate time to arrange for an alternative funding to pay off the accelerated loans, the ratings would face pressure.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry - Apparels
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 2004, JKPL is a part of FFI Global Group, Bengaluru. The company manufactures and exports denim garments, along with sportswear and winterwear. It operates out of its manufacturing facilities in Bengaluru (Karnataka) and Chennai (Tamil Nadu). Besides garment manufacturing, the company has in-house knitting capacities for manufacturing knitted fabric utilised for captive consumption. JKPL caters to the premium denim segment across all the customer segments (men, women and kids) and exports its products to renowned brands in Europe and the US. While the company also markets garments under its own brand, Free Soul, the proportion of these sales remains low. JKPL's Italy-based subsidiary, FFI Global S.R.L, in which it owns a 51.5% stake, acts as a marketing arm and most of JKPL's sales (~80%) to end customers are routed through it.

Key financial indicators

JKPL Standalone	FY2020	FY2021*
Operating Income (Rs. crore)	318.2	203.1
PAT (Rs. crore)	-16.2	-14.7
OPBDIT/OI (%)	9.9%	11.5%
PAT/OI (%)	-5.1%	-7.2%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.3
Total Debt/OPBDITA (times)	5.5	3.7
Interest Coverage (times)	3.4	4.3

Source: JKPL; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation
**Based on provisional financial statements*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated	Amount Outstanding as on June 30, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					September 16, 2021	June 26, 2020	-	-
1	Fund based/ CC	Short Term	60.00	-	[ICRA]A2	[ICRA]A2	-	-
2	Fund based Term Loans	Long Term	54.57	21.58	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	-	-
3	Unallocated	Short Term	15.43	-	[ICRA]A2	[ICRA]A2	-	-

Source: JKPL

Complexity level of the rated instrument

Instrument	Complexity Indicator
Short-term - Fund Based/ Cash Credit	Simple
Term-term - Fund Based TL	Simple
Long-term – Unallocated facilities	Not Applicable

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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
HDFC Bank	PCFC	-	-	-	50.00	[ICRA]A2
HDFC Bank	Ad-hoc working capital limit	-	-	-	10.00	[ICRA]A2
HDFC Bank	Term Loan	2019	-	June 2024	24.57	[ICRA]BBB+ (Stable)
RBL Bank	Term Loan	2018	-	March 2023	30.00	[ICRA]BBB+ (Stable)
NA	Unallocated	-	-	-	15.43	[ICRA]A2

Source: JKPL

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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About ICRA Limited:

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