March 04, 2022

Kitex Garments Limited: Ratings downgraded to [ICRA]A+/[ICRA]A1; Stable outlook assigned; ratings removed from watch with negative implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short term - Fund-based Limits – Working Capital Facilities	182.00	182.00	[ICRA]A1; downgraded from [ICRA]A1+; rating removed from Watch with Negative Implications
Short term - Non-Fund based Limits – Working Capital Facilities	26.50	20.00	
Long term/Short term - Unallocated	34.52	41.02	[ICRA]A+/[ICRA]A1; downgraded from [ICRA]AA-/[ICRA]A1+; Stable outlook assigned; ratings removed from Watch with Negative Implications
Total	**243.02**	**243.02**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the ratings, ICRA has consolidated the business and financial risk profiles of Kitex Garments Limited (KGL) and Kitex Childrenswear Limited (KCL, hereafter collectively referred to as the Group), owing to the common management and strong linkages between the entities.

The revision in the ratings factors in the expected moderation in the Group's credit metrics over the medium term owing to the proposed large debt-funded capacity expansion to be undertaken over the next 24 months, and project execution and market risks, emanating from such an expansion. The Group is expected to incur a capital expenditure of around Rs. 2,600 crore (including pre-operative expenses) for setting up integrated textile units in Telangana across two phases, with the first phase likely to be completed by H1 FY2024 and the second phase by H1 FY2025. The capital investment is to be funded largely by term loans from banks (70% of the project cost), with the rest to be met with internal accruals. While the expansion would strengthen the Group's market position in the infant wear segment and support its business diversification and growth targets over the long term, a significant increase in debt levels is expected to adversely impact its financial profile over the medium term (till the capacities start generating adequate earnings to support improvement in leverage indicators).

The ratings remain supported by the established market position of the Group in the infantwear segment and strong relationship with large customers in the US market, its strong operating efficiencies backed by high levels of automation and integrated manufacturing setup, driving healthy profitability and an expected improvement in business diversification upon commissioning of the proposed capacities. The Group's operating performance has witnessed a healthy recovery in the current fiscal, given the strong growth in orders received from key customers in the recent quarters, after its revenues and earnings were adversely impacted in FY2021 owing to demand and labour disruptions. The operating performance is expected to remain strong in FY2023, given its strong order book position and healthy margins enjoyed in the business. The large expansion exposes its earnings to execution and demand risks, with the new capacities estimated to be at around three times the existing level of operations. Nevertheless, rich experience of the promoters, its strong market position and long relationships with customers, and favourable demand conditions given the increasing shift in procurement of large customers in the US and EU markets from China towards other markets including India provide some comfort. Market players, including the Kitex Group, are expected to benefit from this shift, especially in the infant wear market as China caters to the major part of the requirements and India also holds an edge over other competing nations in this segment. Further, over the medium to long term, expanded capacities would lend diversification benefits with the company planning to venture into new value-added product segments and cater to a wider customer base across geographies.

The Group's capital structure and debt-protection metrics are expected to weaken over the medium term on the back of the proposed investment. ICRA expects the Group's metrics including gearing and total debt to operating profits are likely to increase to peak levels of around 1.5 times and 5 times respectively by FY2024, and further improve in the subsequent fiscals as the capacities start generating earnings. Nevertheless, cash flows and coverage metrics are expected to remain at adequate levels over the next three fiscals, with the minimum debt service coverage ratio (DSCR) expected to be at around 2.0 times. The earnings and liquidity position would be supported by the sizeable subsidies to be enjoyed from the state (although timely receipt of the same remains to be seen) and the healthy margins expected from the new products as well (given the strong value addition and integrated manufacturing setup). The ratings continue to factor in the high customer and geographical concentration risks, high working capital requirements in the business, exposure of the Group's performance to external risk factors such as regulations and duty structures across the markets and fluctuations in foreign exchange rates and input prices, given the limited pricing power enjoyed with established buyers.

The Stable outlook reflects ICRA's expectation that the operational and financial performances of the Kitex Group will continue to benefit from its established presence and leading market position in the infant wear export segment, long relationship with key customers, aiding in repeat orders, ongoing measures towards new customer additions, strong operating efficiencies and favourable demand conditions.

Key rating drivers and their description

Credit strengths

Established market position in the infant wear export segment – The Kitex Group is among the largest manufacturers and exporters of infant wear from India, with a demonstrated track record of more than two decades. The company operates in the niche segment of manufacturing garments for infants, where stringent quality requirements and relationships with customers pose as entry barriers. The promoter's extensive experience in the apparel industry and established relationships with leading international brands supported revenues and earnings over the years. The expected shift in sourcing by large retailers from the competing supplier nations to India, and the proposed diversification into new products and customers are likely to support the long-term growth potential of the Group.

Integrated manufacturing facility – The company has presence across knitting, processing and garmenting segments of the value chain, enhancing operational efficiencies. Besides, presence in the value-added segment (printing and embroidery), healthy levels of automation and strong operational infrastructure to meet stringent quality requirements resulted in better-than-average industry margins for the Group. The proposed addition of spinning facilities and widening of capacities across other sections of the value chain are expected to further improve the overall value addition.

Proposed expansion to improve business diversification – The Group is in the process of diversifying its business profile, with the ongoing capacity expansion expected to improve its product diversification, customer diversification and geographical diversification over the medium to long term. The Group plans to venture into new value-added product categories including infant socks, fleece garments, and premium T-shirts and innerwear for adults, which would reduce its dependence on the infant wear segment. Further, the additional capacity would aid the Group in reducing the concentration risks with specific set of customers and the US market, with plans to widen its client portfolio to include other major retailers in the US and EU markets.

Credit challenges

Proposed large capacity expansion programme – The Group has initiated a large capacity expansion programme of Rs. 2,600 crore in Telangana, to be completed by June 2024, for enhancement of capacities across the value chain. As the expansion would be largely funded though debt (70%), the credit metrics would be adversely impacted in the coming fiscals till the project is completed and the capacity starts generating adequate earnings. Further, the project is in the nascent stage of development and the same exposes its earnings to execution and demand related risks. Despite these risks over the medium term, an expected improvement in the business profile along with the estimated comfortable coverage metrics and liquidity position mitigate the risk to an extent.

High customer and geographical concentration – The Group's revenues remain susceptible to business concentration risk, till the new capacities are commissioned and the Group diversifies its customer base, as more than 90% of its revenues are generated from the US market and a large portion of sales is generated from its top-3 customers. However, the risk is mitigated to an extent by the established relationship enjoyed with its clientele and the continued steps taken by the Group to further diversify its revenue base across products, customers, and geographies.

Limited pricing flexibility exposes earnings to price risk – The Group's earnings remain exposed to fluctuations in raw material prices and exchange rates on the back of limited pricing flexibility enjoyed with key customers. The Group faces competition from other large textile exporters from India as well as from other low-cost garment exporting countries, which limits its ability to improve prices and margins to an extent. While order-backed procurement limits price risk because of movement in yarn prices, its earnings have been protected to a large extent against fluctuations in exchange rates through the hedging arrangement undertaken.

Liquidity position: Adequate

The liquidity position of the Group remains comfortable, with free cash reserves of more than Rs. 150 crore as on December 31, 2021, apart from large unutilised lines of credit enjoyed. Despite the expected increase in working capital requirements and large capital expenditure to be incurred in the coming quarters, the Group's liquidity position is likely to remain adequate. The same would be supported by expected steady cash accruals of more than Rs. 175 crore each in FY2022 and FY2023, cash buffer held and project debt to be availed for funding the capital expenditure, given the strong financial flexibility enjoyed with the banking system.

Rating sensitivities

Positive factors – The ratings may be upgraded upon timely commissioning of the projects without any major cost overruns. Also, the Group's ability to source orders to ensure optimal utilisation of the new capacities being added would also be required for ratings upgrade.

Negative factors – The ratings may be downgraded upon any material time or cost overrus in the commissioning of the projects or upon the Group's inability to source new orders to effectively utilise the fresh capacities being added, which will adversely impact its credit profile. Further, any sustained pressure on the operating performance, or any sharp elongation in its working capital cycle could also result in ratings downgrade. Specific credit metrics that may lead to a rating outlook revision include DSCR reducing to less than 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Indian Textiles Industry – Apparels
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the business and financial risk profiles of KGL and Kitex Childrenswear Limited (collectively referred to as the Kitex Group), owing to the common management and strong linkages

About the company

Kitex Garments Limited (KGL) was incorporated in 1992 and is managed by Mr. Sabu Jacob. The company is a part of the larger AnnaKitex Group, which has diversified interests across various sectors. KGL, along with its Group company, KCL (which holds a 15.9% stake in the company), manufactures and exports infantwear to apparel retailers based out of the US and other developed markets. The Group has a fully integrated manufacturing facility at Kizhakkambalam (Kerala) with a capacity to manufacture around 235 million pieces per annum. The Kitex Group established a marketing and design unit based out of the US in FY2015 (equally held by KGL and KCL) to diversify its business profile and reduce dependence on its key customers. The Group is in the process of setting up two new large integrated manufacturing units in Telangana across two phases in Warangal and Sitarampur, which are expected to fully commercialise by June 2023 and June 2024, respectively. While the unit at Warangal is likely to continue to cater to the childrenswear segment, the Group proposes to diversify into other products including infant socks, fleece garments and premium T-shirts and innerwear for adults from the unit at Sitarampur.

Key financial indicators

Kitex Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	963.2	703.1
PAT (Rs. crore)	124.5	84.6
OPBDITA/OI (%)	21.7%	22.6%
PAT/OI (%)	17.3%	18.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.2
Total Debt/OPBDITA (times)	0.7	0.0
Interest Coverage (times)	19.2	31.7

Source: KGL and KCL; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation

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 (Rs. crore)	Amount Outstanding as (Rs. crore)	Date & Rating in			Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					March 04, 2022	October 01, 2021	July 20,2021	November 11, 2020	October 04, 2019	December 31,2018
1	Fund-based - working capital facilities	Short Term	182.00	-	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Non-fund based working capital facilities	Short Term	20.00	-	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Unallocated	Long Term / Short Term	41.02	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]AA- @/ [ICRA]A1+@	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+

Source: KGL

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund-based Limits – Working Capital Facilities	Very Simple
Non-Fund based Limits – Working Capital Facilities	Very Simple
Unallocated	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 Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Export packing credit and foreign bills discounting	NA	NA	NA	182.00	[ICRA]A1
NA	Letter of Credit and Bank Guarantee	NA	NA	NA	20.00	[ICRA]A1
NA	Unallocated	NA	NA	NA	41.02	[ICRA]A+(Stable)/ [ICRA]A1

Source: KGL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Kitex Littlewear Limited	100%	Full Consolidation
Kitex Babywear Limited	100%	Full Consolidation
Kitex Socks Limited	100%	Full Consolidation
Kitex Packs Limited	100%	Full Consolidation
Kitex Knits Limited	100%	Full Consolidation
Kitex Kidswear Limited	100%	Full Consolidation
Kitex Apparel Parks Limited	70%	Full Consolidation
Kitex Childrenswear Limited	-	Full Consolidation
Kitex USA LLC (note 1)	50%	Equity method
Kitex Herbals Limited (note 2)	-	Full Consolidation
Kitex Infantwear Limited (note 2)	-	Full Consolidation
Kitex Apparels Limited (note 2)	-	Full Consolidation

Source: *Company*

Note 1 - Kitex USA LLC is a 50:50 joint venture between KGL and KCL
Note 2 – These entities are subsidiaries of KCL

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