February 01, 2023

Kapoor Industries Limited: Long-term rating upgraded to [ICRA]AA-(Stable) outlook revised to Stable; short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based term loan	140.79	68.47	[ICRA]AA-(Stable); upgraded from [ICRA]A+(Positive)
Long-term non-fund based	0.25	0.25	[ICRA]AA-(Stable); upgraded from [ICRA]A+(Positive)
Short-term fund-based	314.00	320	[ICRA]A1+; reaffirmed
Short-term non-fund based	2.00	2.00	[ICRA]A1+; reaffirmed
Total	**457.04**	**390.72**	

**Instrument details are provided in Annexure-I*

Rationale

The rating upgrade factors in the continued improvement in the financial risk profile of Kapoor Industries Limited (KIL), led by sustained healthy operating performance, with revenue growth and improvement in profitability in H1FY2023 along with the ongoing de-leveraging of its balance sheet, aided by improvement in the working capital intensity. KIL reported a ~15% YoY revenue growth in H1 FY2023 (as per provisional estimates) after reporting a ~46% YoY growth in revenues in FY2022, which along with healthy profitability supported debt coverage indicators of the company. ICRA expects KIL's financial risk profile to improve further, going forward, with sizeable planned pre-payments and scheduled repayments, which would result in lower debt levels, leading to an improvement in capitalisation and coverage metrics.

The ratings continue to derive strength from KIL's healthy business profile, characterised by its established position among the top exporters of terry towels from India to the US, catering to renowned global brands and value retailers, with a product profile focused on higher value addition in the towels segment. Strong business profile, along with regular, yet calibrated, capex undertaken over the years for capacity expansion, has helped KIL scale up its revenues and improve operational efficiency, facilitating an improvement in its operating margins along with volume-driven cost efficiency. The long-term rating, however, continues to be constrained by competition from other domestic and international suppliers, and high product, customer and geographical concentration risks. Although the company has expanded its product portfolio to include other textile made-ups like bath mats, rugs, bath robes, cooking gloves etc, over the last few years, its dependence on terry towels remains high (~92% in FY2022). Reliance on exports also makes it vulnerable to demand trends in the key export markets and to the foreign exchange fluctuation risk. Further, ICRA has noted the expected near-term demand slowdown in the US, amid inflationary pressure, which is adversely impacting discretionary spending by the consumers. Nevertheless, some comfort is drawn from the industry tailwinds in the form of new FTAs signed with the UAE and Australia in the recent months and any favourable geopolitical developments that may result in business getting re-routed from regions like China and Pakistan over the medium term. With recent capacity enhancements and established job-work arrangements, the company has adequate surplus capacity to scale up operations over the medium term with limited capital outlays.

The Stable outlook on the long-term rating reflects ICRA's expectation of a sustained growth in the medium term, led by the company's operational strengths. ICRA expects KIL to maintain healthy debt coverage metrics and strong liquidity profile, supported by surplus cash flow generation capacity of the business and no major debt-funded capital expenditure plan in the medium term.

Key rating drivers and their description

Credit strengths

Established position in terry towel export industry – KIL is an established manufacturer and exporter of terry towels, featuring among India's top exporters to the US in the category. Besides sales of regular bath towels, KIL has positioned itself as a niche player with focus on fashion and kitchen towels, involving higher value addition with embroidery and use of jacquard looms for designs and patterns. The incremental value addition is reflected in the higher average realisations enjoyed by the company, compared to other domestic players in the terry towel export business.

Long association with leading large format retailers in the US – KIL has an established association with leading large format retailers in the US (like Target, Walmart, Big Lots etc.). Backed by its ability to secure sizeable repeat orders from established clientele and add new customers, KIL's sales witnessed a healthy CAGR of 15% during the 5-year period ended in FY2022. Despite the pandemic-led disruptions in the last two fiscals, KIL reported a healthy volumetric growth, driven by increased demand in the US market, wherein sales for large retailers and home improvement stores grew at a brisk pace. KIL reported an operating income of Rs. 597 crore (growth of ~15% YoY) in H1 FY2023E (provisional estimate) after reporting a growth of ~46% YoY in FY2022 and an operating margin of 18.8% in H1 FY2023E compared to 17.4% in FY2022.

Healthy return metrics – KIL's demonstrated operational efficiencies, its emphasis on value addition, and benefits from the Government in the form of export incentives have supported its stable and healthy profitability over the years, as reflected in an operating margin of 16-18%. Despite industry-wide headwinds witnessed over the past few years (because of adverse movements in forex rates, transitory challenges posed by changes in export incentive schemes, increase in raw material (cotton) prices, etc., KIL's profit margins have remained resilient. In addition, KIL has been undertaking calibrated capex over the years, for capacity expansion and to improve its operational efficiencies. These, in turn, have facilitated an improvement in its operating margins and a consistently healthy ROCE for the company, which stood at an average of ~27% during FY2015-FY2022.

Healthy capitalisation and debt coverage indicators – KIL's healthy profits and cash accruals, together with limited debt repayments, continue to support healthy debt coverage indicators (DSCR of ~4.7 times including for prepayments, in H1 FY2023E). Calibrated capex undertaken by KIL over the years together with low reliance on debt owing to healthy surplus cash accrual generation capacity of the business, has also helped it maintain comfortable leverage (Total Debt/ Tangible Net Worth of ~0.5 times as on September 30, 2022 and Debt/OPBDITA at 1.0 times for H1 FY2023E).

Credit challenges

Product, geographical and customer concentration risks – While KIL has expanded its product portfolio to include other textile made-ups like bath mats, rugs, bath robes, cooking gloves, etc, its dependence on terry towels remains high (accounted for more than ~90% of sales in H1 FY2023 and FY2022). Despite a significant increase in its scale of operations during the last five years, it continues to derive most of its revenues from exports to the US (more than 90% of total exports), resulting in its vulnerability to demand trends in the key market. Besides, the company's customer concentration risk is high, with the top five customers accounting for close to 76% of its sales (average between FY2018 and FY2022).

Vulnerability of profitability to volatility in cotton yarn prices and forex rates – KIL's profitability is vulnerable to volatility in cotton yarn prices as there is a lag between order booking and deliveries. As KIL derives 95% of its revenues from exports (including gains from exchange rate differences and export incentives) with limited dependence on imported raw materials, its profitability is exposed to fluctuations in forex rates. However, the company's demonstrated track record of maintaining stable profitability during the last few years, despite volatility in cotton and cotton yarn prices, provides comfort. Further, KIL's policy of hedging ~65% of its forex exposure partially mitigates the forex risk.

Vulnerability of profitability to changes in export incentive structure – Like other textile exporters, KIL's profitability is supported by export incentives, which historically accounted for ~50% of its operating profits. Besides, these incentives support growth in sales by making domestic textile manufacturers competitive in the global market. This exposes the exporters' profitability to any adverse changes in the policies. In the recent years, there have been several revisions in the export incentive structure as well as rates, which resulted in lack of clarity for exporters while pricing the products. However, the Government's last-year announcement regarding the extension of the Rebate on State and Central Taxes and Levies (RoSCTL) benefits till March 31, 2024 has provided much-needed clarity, supporting exporters' ability to effectively price their products for the next two years.

Seasonality in sales results in skewed working capital requirements – With beach towels accounting for a sizeable proportion of KIL's terry towel sales, the company experiences some seasonality in its sales with the fourth quarter contributing 30-35% to its annual revenues. As a result, working capital requirements peak during the second half of a financial year, resulting in higher utilisation of limits during these months. However, with surplus cash flow generation, the company has been able to maintain a healthy cushion in its working capital limits, which establishes the company's ability to meet the peak requirements.

Liquidity position: Strong

KIL's liquidity position is **strong**, corroborated by a healthy cushion in the form of undrawn working capital limits and free cash and bank balances, aggregating ~Rs.174 crore at the end of December 2022, and averaging ~Rs.178 crore in the 12-month period ended in December 2022. This apart, ICRA expects KIL's cash flows from operations as well as accumulated liquid balance to be more than sufficient to meet debt repayment obligations in the near-to-medium term. ICRA notes that the company has low scheduled repayment obligations and limited capex plans over the next 2-3 years.

Rating sensitivities

Positive factors – ICRA could upgrade KIL's long-term rating if the company achieves a significant growth in its scale, supported by increased business from a wider set of customers and geographies, and enhanced product portfolio. Besides, KIL's ability to maintain a strong profitability and an efficiently managed working capital cycle, resulting in a sustained improvement in its capitalisation and coverage metrics, are positive rating factors.

Negative factors – Pressure on KIL's rating could arise if there is sustained pressure on revenues and profitability and/ or an elongation in the working capital cycle, which constrains its return metrics and liquidity profile, resulting in consistently high utilisation of working capital limits. Besides, higher-than-anticipated dividends/ share buy-back, together with sizeable capex, resulting in increased dependence on external debt, could also trigger ratings downgrade. Specific metrics, which could trigger ratings downgrade, include an interest cover of less than 7.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textile Industry - Fabric Making
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone business and financial risk profiles of KIL.

About the company

Incorporated in 2012 by the Kapoor family and headed by Mr. P. K. Kapoor and Mr. Ashish Kapoor, KIL designs, manufactures and markets textile made-ups like terry towels, bath mats and rugs and bath robes. KIL is amongst the top exporters to the US in its product category with most of its revenues coming in from exports, mainly to the large US-based format retailers like Walmart Stores, Target Sourcing Services, Ross Procurement etc. Its manufacturing units are located in Panipat (Haryana), with weaving capacity of ~22,000 tonnes per annum as of January 31, 2023, as part of company's ongoing capacity expansion, the weaving capacity will increase to ~25,000 tonnes per annum by the end of current fiscal.

Key financial indicators (audited)

KIL Standalone	FY2021	FY2022	H1 FY2023*
Operating income	816	1,197	597
PAT	75	114	61
OPBDIT/OI	18%	17%	19%
PAT/OI	9%	10%	10%
Total outside liabilities/Tangible net worth (times)	1.2	1.3	0.7
Total debt/OPBDIT (times)	1.8	1.7	1.0
Interest coverage (times)	7.8	10.2	9.5

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore * Provisional*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)					Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)*	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020	
					Feb 01, 2023	Jul 29, 2022	Apr 5, 2021	Jun 5, 2020	Jan 24, 2020	May 31, 2019
1	**Long-term fund-based term loan**	Long term	68.47	46	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	**Long-term non-fund based**	Long term	0.25	-	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	**Short-term fund-based**	Short term	320	138	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	**Short-term non-fund based**	Short term	2.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

**Amount outstanding as on September 30, 2022*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based term loan	Simple
Long-term non-fund based	Very Simple
Short-term fund-based	Simple
Short-term non-fund based	Very Simple

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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Long-term fund-based term loan**	FY20-FY22	-	FY2026	68.47	[ICRA]AA-(Stable)
NA	**Long-term non-fund based**	-	-	-	0.25	[ICRA]AA-(Stable)
NA	**Short-term fund-based**	-	-	-	320	[ICRA]A1+
NA	**Short-term non-fund based**	-	-	-	2.00	[ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

Kaushik Das
+91 33 7150 1104
kaushikd@icraindia.com

Vipin Jindal
+91 124 4545 336
vipin.jindal@icraindia.com

Devanshu Gupta
+91 9818994824
devanshu.gupta@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches