September 25, 2023

KH Exports India Private Limited: Ratings downgraded to [ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Letter of Credit	70.00	70.00	[ICRA]A1; downgraded from [ICRA]A1+
Credit Exposure Limit/ Loan Equivalent Risk	12.00	12.00	[ICRA]A1; downgraded from [ICRA]A1+
Bank Guarantee^	(5.00)	(5.00)	[ICRA]A1; downgraded from [ICRA]A1+
Untied Limits	43.00	43.00	[ICRA]A1; downgraded from [ICRA]A1+
Total	**125.00**	**125.00**	

**Instrument details are provided in Annexure-I; ^sublimit of Letter of Credit*

Rationale

The rating downgrade of KH Exports India Private Limited (KHEIPL/the company) reflects a sharp drop in its operating profit margin in FY2023 to an all-time low of 2.4% (against 10.3% in FY2022 and a median of 7.3% during the pre-Covid era) amid cost pressure primarily emanating from the increase in minimum wages for labour in Tamil Nadu and losses from the sale of obsolete inventory. This weakening in profitability had an adverse impact on the coverage metrics of KHEIPL with the interest coverage declining to 3 times in FY2023, breaching the downward rating trigger of 7.0 times. Additionally, with muted export demand growth prospects and cost pressure constraining the profit margins in the current fiscal, ICRA expects the company's interest coverage to remain subdued in FY2024 as well. Apart from labour costs, the company's margins are also impacted by the volatility in leather prices, although its ability to partly pass on the price increase to its customers mitigates the risk to a large extent. The rating also reflects KHEIPL's relatively higher customer concentration risk and its weak bargaining power against large international customers. Besides, limited presence of own branded product limits its scope for margin improvement. The company is also exposed to geographical concentration risks with the major portion of its exports made to the US and European markets. ICRA observes that with 55-60% of the revenues coming from the US markets, the company remains susceptible to demand cyclicality in this key end-user market. KHEIPL is also prone to regulatory risks and the resultant operational disruption, with restrictions on sourcing of animal hides and stringent pollution control norms on effluents (generated during the tanning process), as well as any change in the state's labour laws.

The rating, however, favourably takes into consideration its established position as one of India's largest leather footwear and apparel exporters, its long relationship with globally reputed brands and considerable experience of its promoters. The rating also derives comfort from the integrated nature of KHEIPL's operations with an in-house tannery, sole manufacturing, and lining facilities. KHEIPL has a diverse product offering in the leather products space that includes bags, shoes, belts, gloves and other small leather products which enable them to provide an array of products to all its clientele.

Key rating drivers and their description

Credit strengths

Established player in the leather footwear/accessories business, led by experienced promoters – KHEIPL is one of the largest players in the Indian leather footwear/accessories exports industry with a track record of more than seven decades. The company is a family promoted business, but the promoters have extensive experience in the industry.

Reputed clientele comprising top global brands in the industry – The company has an established customer base comprising reputed brands like Coach Manufacturing, Cole Haan, Prada, Marks & Spencer, Ralph Lauren Corporation, Tory Burch etc. KHEIPL's customer churn rate has remained minimal over the years, indicating healthy relationships with its clients.

Integrated operations, with the Group having its own tannery, sole manufacturing and lining facilities supporting profit margins – The integrated nature of the company's operations, with in-house tannery, manufacturing and lining facilities, leads to cost benefits arising from bulk procurement. This ensures quality control and helps capture value addition across the supply chain. It also helps maintain quality of products and timeliness of orders.

Diversified product portfolio spread across various leather-based products – The revenues of the company are well diversified across leather and leather goods spectrum following the merger of the tanning unit, shoe manufacturing unit and the leather gloves unit to the existing accessories manufacturing division of the Group (done in FY2013). The production mix depends on existing demand and profitability. In FY2023, leather full shoes remained the company's mainstay, accounting for 42% of the revenue, followed by leather bags (27%) and gloves, belts and other small leather products (~30%).

Credit challenges

Decline in operating performance, leading to a moderation in coverage metrics; margins and coverage metrics expected to remain suppressed in FY2024 as well – In FY2023, the operating profit margin for KHEIPL declined to an all-time low of 2.4% (against 10.3% in FY2022 and a median of 7.3% during the pre-Covid era), affected by the cost pressure primarily emanating from the upward revision in minimum wages for labour in Tamil Nadu and losses from the sale of obsolete inventory. This weakening in profitability had an adverse impact on the coverage metrics of KHEIPL with the interest coverage declining to 3 times in FY2023, reaching below the downward rating trigger of 7.0 times. Additionally, with muted export demand growth prospects and cost pressure constraining profit margins during the current fiscal, ICRA expects the company's interest coverage to remain subdued in FY2024 as well.

Exposed to volatility in leather prices and rising labour costs – The company imports a large portion of its leather requirements and is thus exposed to volatility in leather import prices, although its ability to partly pass on the price increase to its customers mitigates the risk to a large extent. Additionally, it witnessed a significant increase in labour costs in FY2022 and FY2023 largely due to a rise in minimum wage prescribed under labour laws in Tamil Nadu in 2021. ICRA notes that the company has finalised with its customers to pass on the labour cost hike in FY2023 and is likely to witness its benefit in the current year.

High customer and geographical concentration risks – The company faces high customer concentration risk with its top three customers accounting for more than 50% of its revenues. However, the company enjoys an established relationship with these marquee customers, which have been awarding it with repeat businesses. That said, association with reputed brands restricts its bargaining power. Limited presence of its own branded products (~1% of revenue) limits its scope for margin improvement. The company is also exposed to geographical concentration risks as the major portion of its exports are made to the US and European markets. With 55-60% of the revenues coming from the US markets, the company remains susceptible to demand cyclicality in this key end-user market.

Exposure to changes in environmental regulations, power and labour issues – The industry is prone to regulatory risks with restrictions on sourcing of animal hides and stringent pollution control norms on effluents generated during the tanning process, as well as any change in the state's labour laws. The manufacturing process, being labour and power intensive, is also susceptible to issues related to power shortage and labour demands.

Liquidity position: Strong

KHEIPL's liquidity position is strong with unencumbered cash and liquid investment of around Rs. 44 crore as on March 31, 2023 coupled with its debt-free status and moderate capex plans, going forward. Further, its modest working capital intensity driven by efficient receivables and inventory management enables KHEIPL to maintain a strong liquidity position. The same is reflected by the moderate utilisation of non-fund-based limits in the 12-month period ending in July 2023 (average utilisation level of 36%).

Rating sensitivities

Positive factors – ICRA may upgrade the rating for KHEIPL if there is a sustained improvement in revenues and profitability levels leading to strengthening of the operating profile for the company. The rating could also be upgraded if a reduction in the working capital intensity leads to significant improvement in the liquidity profile of the company. Specific credit metric that could lead to rating upgrade includes an interest coverage above 7.0 times on a sustained basis.

Negative factors – Pressure on the rating could arise if there is a sustained decline in revenue or weakening of profitability, or if any adverse change in the regulations impacts the sector. The rating could also come under pressure if a stretch in the working capital intensity adversely impacts the liquidity profile of the company. Specific credit metric that could lead to rating downgrade includes an interest coverage below 5.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[Corporate Credit Rating Methodology] [Rating Methodology - Footwear]
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone financial statement of the issuer

About the company

KH Exports India Private Limited was incorporated as Rabia Leather Industries Ltd. (Rabia) in 1985 and is a 100% export-oriented unit with ISO 9001-2000 certification. The KH Group traces its origins to the tannery business set up by Mr. M.A. Khizar Hussain in 1947. Over the years, the Group has expanded manifold and included numerous companies involved in manufacturing of different leather products. Over FY2014-FY2016, the Group undertook a restructuring exercise, whereby all the major entities of the Group were merged with KH Exports, which made the company one of India's largest exporters of leather shoes and products. The manufacturing units of the company are in various locations in Tamil Nadu, namely Poonamalle in Chennai, Ranipet and also in Vellore, with an overall built-up area of 17,10,000 square feet. The company has in-house tannery, sole manufacturing, lining and shoe assembling facilities. The manufacturing units have a capacity to process 25 million sq. ft. of leather and can manufacture up to 2 million pairs of full shoes, 1.2 million bags, 3 million small leather goods (wallets, key chains), 1 million belts and 2 million gloves per annum. The company caters to a reputed clientele, including Coach Manufacturing, Cole-Haan, Marks & Spencer, Ralph Lauren Co., Sioux GmbH, Michael Kors, Genesco and H&M among others.

Key financial indicators (audited)

KEIPL Standalone	FY2022	FY2023*
Operating income	1300.6	1464.2
PAT	79.1	2.0
OPBDIT/OI	10.3%	2.4%
PAT/OI	6.1%	0.1%
Total outside liabilities/Tangible net worth (times)	0.6	0.5
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	23.1	3.0

*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 (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021
					Sept 25, 2023	Jun 30, 2022	Nov 22, 2021	Nov 05, 2021	Mar 08, 2021
1	**Letter of Credit**	Short term	70.00	30.14	**[ICRA]A1**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
2	**Credit Exposure Limit/ Loan Equivalent Risk**	Short term	12.00	--	**[ICRA]A1**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
3	**Bank Guarantee***	Short term	(5.00)	--	**[ICRA]A1**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
4	**Untied Limits**	Short term	43.00	--	**[ICRA]A1**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-

**sublimit of Letter of Credit*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Letter of Credit	Very Simple
Credit Exposure Limit/ Loan Equivalent Risk	Very Simple
Bank Guarantee	Very Simple
Untied Limits	NA

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	Letter of Credit	NA	NA	NA	70.00	[ICRA]A1
NA	Credit Exposure Limit/ Loan Equivalent Risk	NA	NA	NA	12.00	[ICRA]A1
NA	Bank Guarantee*	NA	NA	NA	(5.00)	[ICRA]A1
NA	Untied Limits	NA	NA	NA	43.00	[ICRA]A1

*Source: Company data, *sublimit of Letter of Credit*

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

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

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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.

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