July 05, 2024

Kitex Childrenswear Limited: Ratings downgraded to [ICRA]A2+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term – Fund-based	105.00	90.00	[ICRA]A2+; downgraded from [ICRA]A1
Short-term – Non-fund based	12.00	12.00	[ICRA]A2+; downgraded from [ICRA]A1
Short-term – Unallocated	0.00	15.00	[ICRA]A2+; downgraded from [ICRA]A1
Total	**117.00**	**117.00**	

**Instrument details are provided in Annexure-I*

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 ratings considers the expected moderation in the Group's financial profile over the medium term, amid an increase in project cost by ~Rs. 400 crore (due to an enhancement in the scope) on the large debt-funded expansion currently being undertaken by the Group. The Group is in the process of setting up integrated textile units in Telangana, in two phases under Kitex Apparel Parks Limited (KAPL[1]), at a total cost of ~Rs. 2,890 crore (including preoperative expenses), to be funded by term loans from banks (70%) and promoter contributions. While there was no cost overrun as of March 2024, the overall project cost is expected to increase by ~Rs. 400 crore due to an increase in the scope of the project towards automating seamless movement of goods across units through conveyors, addition of power substations and other improvements.

The project's first phase is likely to be completed by the end of March 2025 and the second by the end of March 2026. While the entity had anticipated to complete its first phase a year ahead of the Scheduled Date of Commencement (SCOD), the same could not be completed owing to operational reasons and the entity now expects to commence spinning operations at Warangal by September 2024. The large expansion exposes the Group's earnings to execution and demand risks, with the new capacities being sizeable in comparison to its existing operations. While the Group's debt protection metrics will be subdued in FY2025 (amid the ongoing debt-funded capex phase), the same will improve in subsequent fiscals upon commencement of the first phase of operations from FY2026. Receipt of Government subsidies after operations begin would support the Group's liquidity position to an extent (although timely receipt of the same remains a key monitorable).

The ratings continue to factor in the project execution and implementation risks, customer acquisition risk for the new project, existing high customer and geographical concentration risks, and inherently high working capital requirements in the business. Furthermore, Group's operations are susceptible 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 by the Group.

The ratings continue to remain supported by the established market position of the Group in the infantwear segment along with long-standing relationships with its customers. Further, the demand conditions in the long run remain favourable, given the increasing shift in procurement by large customers in the US and EU markets from China towards other markets, including

[1] *Entity held by KGL (~70%) and KCL (~30%)*

India. ICRA notes the improvement in the Group's overall operating and financial performances in H2 FY2024, following recovery in demand from key export markets the US and EU. Overall, in FY2024, the Group's revenue witnessed ~18% YoY growth and operating margins improved by 290 bps to ~20.7%.

The Group's operational profile remains supported by a high level of automation and integrated manufacturing set-up leading to strong profit margins, and an expected improvement in business diversification upon commissioning of the proposed capacities. Further, over the medium-to-long-term, expanded capacities would enable diversification benefits with the Group planning to venture into new, value-added product segments for a wider customer base across geographies.

The Negative outlook reflects the execution risks associated with the large debt-funded capacity expansion currently being undertaking by the Group.

Key rating drivers and their description

Credit strengths

Established market position in the infantwear export segment – The Kitex Group is among the largest manufacturers and exporters of infantwear from India, with a track record of more than two decades. The Group 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 have supported its revenues and earnings over the years. The expected shift in sourcing by large retailers to India from competing supplier nations, and the Group's proposed diversification to new products and customers are likely to support its long-term growth potential.

Integrated manufacturing facility – The Group has presence across knitting, processing and garmenting segments, 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 have resulted in better-than-average industry margins for the Group. The proposed addition of spinning facilities for KAPL 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, customer and geographical diversification over the medium-to-long-term. Further, the additional capacity would aid the Group in reducing its concentration risks with specific customers and the US market, along with its plans to widen its client portfolio to include other major retailers in the US and EU markets.

Credit challenges

Debt coverage metrics to moderate over the medium term owing to proposed large, debt-funded capex – KAPL is in the process of setting up a large, textile greenfield capacity in two phases for ~Rs. 2,890 crore in Telangana, to be completed by March 2026. There has been no cost overrun as of March 2024. However, due to increase in the scope of the project, the overall project cost is expected to increase by ~Rs. 400 crore to Rs. 3,290 crore. Debt towards the increased scope is yet to be tied up, awaiting certain approvals. This increase in scope would lead to additional outlay of funds, thereby stretching the Group's credit metrics over the medium term. Further, as the expansion would be largely funded through debt (70% by term loans and the remaining through promoter contributions), the financial profile would remain modest till the project is completed and would improve with the capacity generating adequate earnings. Also, the entity would be eligible for various state government incentives towards the project. The receipt of these would support the profitability and liquidity profile for the Group over the medium term. ICRA notes that the management also has deleveraging plans over the medium term; however, the same remains to be seen.

Exposure to project and market risks owing to large, proposed debt-funded greenfield capacity – The Telangana project is at a nascent stage of development, which exposes its earnings to execution related time and cost overruns inherent to large projects. The company has incurred ~Rs. 1,058 crore till April 24, 2024, without any cost overruns. However, due to an increase in the scope of the project, the overall project cost is expected to increase by ~Rs. 400 crore. This additional cost will go towards automating seamless movement of goods across manufacturing units, addition of power stations and improvements in air conditioning at the plants. The first phase is likely to be completed by the end of March 2025 and the second by the end of March 2026. The project would also be exposed to market risks upon commissioning, considering the large capacity being added. However, the Group's established presence is likely to support KAPL in securing orders. Also, the management has indicated that initially, surplus orders that could not be processed from its existing Kerala facility would be processed from its Telangana unit, as the first phase of operations begin, providing initial revenue visibility.

High customer and geographical concentration risks – The Group's revenues remain susceptible to business concentration risk, till the new capacities are commissioned and the Group diversifies its customer base. ICRA notes that more than 90% of its revenues is generated by the US market and a large share of sales is generated by its top-3 customers. However, the risk is mitigated to an extent by the established relationship enjoyed with its clientele and the 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 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 are largely protected against fluctuations in exchange rates through its hedging arrangement.

Environmental and Social Risks

Environmental considerations: The sector remains exposed to the risks of elevated input costs owing to increased compliance expenses faced by suppliers amid tightening environmental regulations. The industry is exposed to environmental risks, primarily through water, land use, and the impact of climate on production as well as post-consumer waste. While these risks have not resulted in any material implication, policy actions towards waste management like recycling textiles could have cost implications for companies like KCL. Any disruption in measures taken for appropriate treatment of wastewater/effluents could result in significant penalties, while also causing prolonged adverse impact on operations if the authorities take any strict action.

Social considerations: Being a labour-intensive sector, garment manufacturing entities are exposed to the risks of disruptions caused by their inability to manage human capital in terms of their safety and overall well-being. Besides, human rights issues and the inability to ensure diversity, while providing equal opportunity, could pose social risks for the company. Further, any significant increase in wage rates may affect the cost structure of apparel manufacturers, impacting their margins. Shortage of skilled workers could also affect operations/growth plans and remains a key concern. Measures taken by the company towards employee welfare have not resulted in any material impact on its performance from the above-mentioned risks. Further, garment manufacturers are exposed to the risks of conflicts with local communities. Entities also remain exposed to major shift in consumer preferences or developments, affecting discretionary consumer spending in key markets.

Liquidity position: Adequate

The Group's liquidity position is likely to remain adequate despite the large ongoing debt-funded expansion. The same would be supported by the expected steady cash accruals in forthcoming years, cash buffer held and project debt to be availed for part funding the capital expenditure, given the strong financial flexibility it enjoys with the banks. There is no scheduled debt repayment in FY2025, but it has a debt repayment obligation of Rs.10.4 crore in FY2026. The Group had free cash reserves of ~Rs. 72 crore as on March 31, 2024 and a cushion in fund-based working capital limits averaging ~Rs. 148 crore on combined sanctioned lines (KGL and KCL) during the last six months ending in April 2024. Further, it is required to maintain one quarter's principal and interest amount due in the Debt Service Reserve Account (DSRA) under KAPL. DSRA is required to be opened before one quarter of commencement of scheduled repayments of term loan (i.e., towards the middle of FY2026).

Rating sensitivities

Positive factors – The rating may be upgraded if if the entity is able to sustain its revenue growth and margin expansion in the medium term, leading to an improvement in its return and debt protection metrics.

Negative factors – The rating may be downgraded in case of any sustained pressure on the Group's operating performance, or any sharp elongation in its working capital cycle. Further, any material time or cost overrun in the new project could result in a rating downgrade. Specific credit metrics that may lead to a downward rating include DSCR reducing to less than 1.8 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Textiles – 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 KCL (collectively referred to as the Kitex Group), owing to the common management and strong linkages among them.

About the company

KCL was incorporated in 1991 and is managed by Mr. Sabu Jacob. KCL, along with its Group company, KGL (in which KCL holds a 15.9% stake), manufactures and exports infantwear to apparel retailers in the US and other developed markets. The Group has an integrated manufacturing facility at Kizhakkambalam (Kerala) with a manufacturing capacity of around 8.5 million pieces per day. The Kitex Group had established a marketing and design unit in 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 at Warangal and Sitarampur in Telangana across two phases, which are expected to commercialise by March 2025 and March 2026, respectively.

Key financial indicators (audited/ provisional)

Consolidated	FY2023	FY2024*
Operating income	722.2	849.0
PAT	67.2	99.0
OPBDIT/OI	17.8%	20.7%
PAT/OI	9.3%	11.7%
Total outside liabilities/Tangible net worth (times)	0.2	0.8
Total debt/OPBDIT (times)	0.4	4.2
Interest coverage (times)	20.7	17.0

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*

PAT: Profit after tax; OPBDIT: 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 (FY2025)			Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022		
				Jul 5, 2024	Jun 30, 2023	Mar 31, 2023	Dec 13, 2022	Mar 04, 2022	Oct 01, 2021	Jul 20,2021
1	Fund-based Limits – Working Capital Facilities	Short Term	90.00	**[ICRA]A2+**	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+
2	Non-Fund based Limits – Working Capital Facilities	Short Term	12.00	**[ICRA]A2+**	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+
3	Unallocated	Short Term	15.00	**[ICRA]A2+**	-	-	[ICRA]A1	[ICRA]A1	-	-

@: Rating Watch with Negative Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based - working capital facilities	Very Simple
Non-fund based working capital facilities	Very Simple
Unallocated limits	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 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	Fund-based Limits – Working Capital Facilities	NA	NA	NA	90.00	[ICRA]A2+
NA	Non-Fund based Limits – Working Capital Facilities	NA	NA	NA	12.00	[ICRA]A2+
NA	Unallocated	NA	NA	NA	15.00	[ICRA]A2+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Kitex Herbals Limited	100%	Full Consolidation
Kitex Infantwear Limited	100%	Full Consolidation
Kitex Apparels Limited	100%	Full Consolidation
Kitex USA LLC (note 1)	50%	Equity method
Kitex Apparel Parks Limited	30%	Full Consolidation
Kitex Littlewear Limited (note 2)	-	Full Consolidation
Kitex Babywear Limited (note 2)	-	Full Consolidation
Kitex Socks Limited (note 2)	-	Full Consolidation
Kitex Packs Limited (note 2)	-	Full Consolidation
Kitex Knits Limited (note 2)	-	Full Consolidation
Kitex Kidswear 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 KGL

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