

January 07, 2025

Kitex Garments Limited: Ratings reaffirmed; outlook revised to Stable from Negative

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 | 185.00 | 185.00 | [ICRA]A2+; reaffirmed |
| Short term - Non-Fund based Limits – Working Capital Facilities | 20.00 | 20.00 | [ICRA]A2+; reaffirmed |
| Long term/Short term - Unallocated | 20.02 | 20.02 | [ICRA]A (Stable) / [ICRA]A2+; reaffirmed and outlook revised to Stable from Negative |
| Short term - Non-Fund based Limits – Credit Exposure Limits | 18.00 | 18.00 | [ICRA]A2+; reaffirmed |
| Total | 243.02 | 243.02 | |

*Instrument details are provided in Annexure-I

Rationale

For arriving at the rating, 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 rating action considers the healthy performance of the Group in H1 FY2025 and expectation of sustained growth in revenues over the near-to-medium term, supported by favourable demand condition with increasing shift in procurement by large customers in the US and EU markets from China towards other markets, including India. The ratings also consider that the Phase-II expansion, which is expected to be completed in a phased manner by March 2027, is likely to support its cash flows and debt repayment obligations over the medium term.

The rating continues to remain supported by the established market position of the Group in the infantwear segment along with long relationships with its customers. The Group's overall operating and financial profiles recovered post H2 FY2024 with increase in orders processed from the US markets. This is likely to sustain as the demand conditions remain favourable in the near-to-medium run. In H1 FY2025, the consolidated revenues grew by 46% (on an annualised basis) to Rs. 613 crore and the operating margins improved by 290 bps to 23% in H1 FY2025. This follows a ~16% YoY revenue growth witnessed in FY2024 and the operating margins improving by 240 bps to ~20.1% in FY2024. 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. ICRA notes that KGL is in the process of acquiring the business of KCL.

The Group is in the process of setting up integrated textile units in Telangana, in two phases under Kitex Apparel Parks Limited (KAPL), at an initial cost of ~Rs. 2,890 crore (including preoperative expenses), to be funded by term loans from banks (70%) and promoter contributions. There had been a change in scope towards automating seamless movement of goods across the units through conveyors, addition of power substations and other improvements, leading to an increase in the project cost of phase I by Rs. 261 crore to Rs. 1,751 crore. ICRA understands that the phase-II expansion of the project shall be completed in a phased manner by March 2027 (being revised by a year from initial estimates) while cost escalation in relation to Phase II is likely to be Rs. 200 crore. The project's phase I is likely to be completed by the end of March 2025 and the phase II by the end

of March 2027. Large expansion exposes the Group's earnings to execution and demand risks, with the new capacities being sizeable than 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 the subsequent fiscals upon commencement of the phase I of operations from FY2026 and the phase II by FY2028. Receipt of Government subsidies after beginning of operations would support the Group's liquidity position to an extent (although timely receipt of the same remains a key monitorable).

The rating continues 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. Besides, the 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.

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 its 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 expected from January 2025 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, 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. 3,350 crore (including expected cost escalation) in Telangana. There has been a cost escalation due to increase in scope towards automating seamless movement of goods across the units through conveyors, addition of power substations and other improvements, leading to an increase in the project cost of Phase I by Rs. 261 crore to Rs.1,751 crore. Further, expansion of the phase II of the project is likely to be completed in a phased manner by the new COD of March 2027 and cost escalation in relation to the same is expected to be Rs. 200 crore. While the increase in scope would lead to additional outlay of funds, stretching the Group's credit metrics, the phased completion of its phase-II expansion by March 2027 will support its cashflows and repayment obligations over the medium term. As the expansion is 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 – While the phase I of the project is almost nearing completion, the phase II of the project is at a nascent stage of development, which exposes its earnings to execution related time and cost overrun inherent to large projects. The company has incurred ~Rs. 1,337.8 crore till November 30, 2024. However, the overall project cost is expected to increase due to a rise in the scope of the project. The phase I is likely to be completed by the end of March 2025 and the phase II by the end of March 2027 (revised from the previous expected completion date 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. 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.

Exposed to 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 are generated from the US market and a large share of sales comes from 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 risk of disruptions caused by their inability to manage human capital in terms of their safety and overall well-being. Besides, human rights issues and 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 the 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 debt repayment obligation of ~Rs. 12 crore in FY2026 (including estimated repayment obligation for the new term loan for increase in scope). 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. 95 crore on combined sanctioned lines (KGL and KCL) during the last seven months ending in October 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 after completion of one year from DCCO of both units (i.e., towards the end of FY2027).

Rating sensitivities

Positive factors – The rating may be upgraded if the Group reports a sustained revenue growth, improve its profitability and working capital cycle, resulting in better return indicators, debt coverage metrics and liquidity profile.

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 metric that may lead to a downward revision of rating includes 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 production capacity of around 8.62 lakh pieces per day. The Kitex Group 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 2027, respectively.

Key financial indicators (audited)

| Consolidated | FY2023 | FY2024 | H1FY2025* |
|--|--------|--------|-----------|
| Operating income | 727.7 | 840.9 | 613.3 |
| PAT | 67.2 | 88.1 | 96.4 |
| OPBDIT/OI | 17.7% | 20.1% | 23.0% |
| PAT/OI | 9.2% | 10.5% | 15.7% |
| Total outside liabilities/Tangible net worth (times) | 0.2 | 0.8 | - |
| Total debt/OPBDIT (times) | 0.4 | 4.4 | - |
| Interest coverage (times) | 20.7 | 14.4 | 18.8 |

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 | |
| | | | Jan 7, 2025 | Jul 5, 2024 | Jun 30, 2023 | Mar 31, 2023 | Mar 04, 2022 | Oct 01, 2021 | Jul 20, 2021 |
| 1 Fund-based Limits – Working Capital Facilities | Short Term | 185.00 | [ICRA]A2+ | [ICRA]A2+ | [ICRA]A1 | [ICRA]A1 | [ICRA]A1 | [ICRA]A1+@ | [ICRA]A1+ |
| 2 Non-Fund based Limits – Working Capital Facilities | Short Term | 20.00 | [ICRA]A2+ | [ICRA]A2+ | [ICRA]A1 | [ICRA]A1 | [ICRA]A1 | [ICRA]A1+@ | [ICRA]A1+ |
| 3 Unallocated | Long Term / Short Term | 20.02 | [ICRA]A (Stable)/ [ICRA]A2+ | [ICRA]A (Negative)/ [ICRA]A2+ | [ICRA]A+ (Negative)/ [ICRA]A1 | [ICRA]A+ (Stable) / [ICRA]A1 | [ICRA]A+ (Stable)/ [ICRA]A1 | [ICRA]AA-@/ [ICRA]A1+@ | [ICRA]AA- (Stable)/ [ICRA]A1+ |
| 4 Non-Fund based Limits – Credit Exposure Limits | Short Term | 18.00 | [ICRA]A2+ | [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 |
| Non-fund based Credit Exposure Limits | 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 | Fund-based Limits – Working Capital Facilities | NA | NA | NA | 185.00 | [ICRA]A2+ |
| NA | Non-Fund based Limits – Working Capital Facilities | NA | NA | NA | 20.00 | [ICRA]A2+ |
| NA | Unallocated | NA | NA | NA | 20.02 | [ICRA]A(Stable)/ [ICRA]A2+ |
| NA | Non-Fund based Limits – Credit Exposure Limits | NA | NA | NA | 18.00 | [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 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 USA LLC (note 1) | 50% | Equity method |
| Kitex Apparel Parks Limited | 70% | Full Consolidation |
| 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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