June 05, 2020

Kapoor Industries Limited: [ICRA]A+(Stable)/[ICRA]A1+ assigned for enhanced amount

Summary of Rating Action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facilities	82.92	133.30	[ICRA]A+(Stable); outstanding/assigned
Long-term non-fund based bank facilities	0.25	0.25	[ICRA]A+(Stable); outstanding
Short-term fund-based bank facilities	157.00	238.75	[ICRA]A1+; outstanding/assigned
Short-term non-fund based bank facilities	1.00	2.00	[ICRA]A1+; outstanding/assigned
Total	**241.17**	**374.30**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating reflects Kapoor Industries Limited's (KIL's) healthy operational and financial risk profile. KIL has an established position as a supplier of towel and bath mats to renowned global brands and value retailers, corroborated by its position among the top five exporters of terry towels from India to the US. Besides established client relationships, the same is facilitated by the company's focus on designs and textures rendering higher value addition for its products. The strong operational profile has helped the company maintain healthy profitability over the years, supporting its return metrics (return on capital employed averaging at ~25% during FY2017-FY2019) as well as debt coverage metrics (interest cover of more than 6.0 times, and Debt/OPBDITA less than 2.5 times in FY2020E).

Even though the Covid-19 pandemic and resultant lockdown in India towards the end of FY2020 resulted in deferment of shipments, KIL maintained a healthy revenue growth during the year (YoY revenue growth of over ~10%). Moreover, the impact of the pandemic on the company's sales in FY2021 is expected to be somewhat cushioned by its strong network of buyers. Its buyers include large retailers in the US, who continued to remain operational even during the lockdown for supplying other essential items. Despite lockdowns getting lifted/ relaxed across regions, however, sales are likely to be affected amid overall pressures on discretionary consumer spending. Although the towels segment is expected to be more resilient than other home textiles categories, since it is a relatively low-ticket utility product, the same is not immune to expected contractions in consumer spending. Accordingly, ICRA will continue to monitor the developments on this front as the situation evolves, and may review the rating, if warranted. Nevertheless, the rating derives comfort from the steps taken by the management to protect its liquidity and maintain an adequate buffer, in light of the decline in sales as well as several additional challenges, such as possible elongation of working capital cycle. These include promoters' stated stance of retaining funding support in the form of unsecured loans, limiting withdrawals in the form of dividends, as well as rationalising capex from the earlier envisaged levels.

The rating, however, remains constrained by the vulnerability of KIL's profitability to volatility in cotton yarn prices as there is a lag between order booking and deliveries, competition from other domestic and international suppliers, along with 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 FY2019). Besides, high reliance on beach towels within the terry towels segment, results in seasonality in sales and skewed working capital requirements. Reliance on exports also makes it vulnerable to demand trends in the key export markets (exports to the US account for more than 85% of the total exports) and to foreign exchange fluctuation risk.

The Stable outlook reflects ICRA's expectation that KIL will maintain its strong market position in the terry towel export industry, and continue to benefit from its established relations with large global retailers. Despite moderation in performance in the current fiscal, KIL's debt coverage metrics are expected to remain healthy and liquidity profile comfortable.

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 five exporters to the US in the category. Besides sales of regular bath towels, it has positioned itself as a niche player with focus on fashion and kitchen towels, involving higher value addition through use of embroidery and 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 and Walmart) as well as high-end private labels/brands (like Nautica and Tommy Hilfiger). Backed by its ability to secure sizeable repeat orders from established clientele and add new customers, KIL's sales grew at a healthy CAGR of 18% during the 10-year period ended FY2020E. While the pace of growth slowed down in FY2018 and FY2019 owing to industry-wide challenges (corroborated by a degrowth reported by several leading players in the sector during FY2018), it picked up in FY2020 (estimated YoY growth of over ~10% in FY2020). Despite the demand-side disruptions caused by the Covid-19 pandemic, which are likely to affect the industry as well as the KIL's turnover in FY2021, the impact on KIL's performance is expected to be somewhat cushioned by established retail chains, such as Target and Walmart, in its customer base.

Track record of stable and healthy profitability - 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 the operating margins of 13-15%. Despite industry-wide headwinds witnessed over the past few years (because of adverse movements in forex rates, transitory challenges posed by shift in taxation regime to the Goods and Services Tax or GST, changes in export incentives, increase in raw material (cotton) prices, and growth pressures due to de-stocking by US retailers), KIL's profitability remained steady. This, in turn, supported healthy return on capital employed (ROCE), which averaged at ~26% during FY2016-FY2020E. Although the ROCE is expected to moderate in the near term owing to expected moderation in performance in the current fiscal, it is expected to remain healthy (in the range of ~15-18%).

Healthy debt coverage indicators - KIL's healthy profits and cash accruals, together with limited debt repayments, continue to support healthy debt coverage indicators. 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, helped it maintain comfortable leverage in the past. Although a scale up of debt-funded capex in recent years has resulted in increased reliance on external debt, KIL's debt coverage metrics remain comfortable as reflected by External Debt/OPBDITA at ~1.5 times, and interest cover of over 6.0 times in FY2020E. Further, the ratings draw comfort from the infusion of additional funds by promoters, which has supported the company's liquidity profile and kept its dependence on external debt low. Besides, its liquidity profile is also supported by timely enhancement of working capital limits from banks. As a result, despite the expected moderation in its performance in the current fiscal, KIL's financial profile is expected to remain comfortable. In this context, the rating also derives comfort from the promoters' stated stance of maintaining adequate liquidity in the company by retaining unsecured loans, limiting withdrawals in the form of dividends, as well as rationalising capex from the earlier envisaged levels.

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 92% of sales in FY2019). Further, despite the significant increase in scale of operations during the last five years, it continues to derive most of its revenues from exports to the US (more than 85% of total exports), resulting in vulnerability to demand trends in the key market. Besides, the company's customer concentration risk is high, with its top five customers accounting for more than 70% of its sales.

Vulnerability of profitability to volatilities in cotton yarn prices and fluctuations in forex rates - KIL's profitability is vulnerable to volatility in cotton yarn prices, as there is a lag between order booking and deliveries. Further, as KIL derives 97% of its revenues from exports with limited dependence upon 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 volatilities in cotton and cotton yarn prices, provides comfort. Further, KIL's policy of hedging 60% 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 as much as ~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 this context, ICRA notes that the textile industry has been facing multiple challenges amid subdued demand trends in some of the key markets, intense competition from other nations as well as uncertainty on export incentives. Post transition to the GST regime, there were multiple changes in export incentives structure, and clarity on export incentives under the Merchandise Export Scheme of India (MEIS) and Rebate on State and Central Taxes and Levies (RoSCTL) came only in January 2020. Further, exporters faced significant delays in receipt of incentives during FY2020, and the receipt of incentives was regularised only towards the end of FY2020 as clarity on structure as well as the process of claiming incentives emerged. The Government of India also cleared a new incentive scheme towards the end of March 2020, the Remission of Duties or Taxes on Export Products, which is expected to subsume all incentives available to exporters under various schemes. However, clarity on when the scheme would become effective as well as proposed rates under the same is still awaited. A downward revision in export incentives may impact the profitability of exporters.

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 of a financial year typically accounting for 30-35% of its annual revenues. As a result, working capital requirements typically peak out during the second half of a financial year, resulting in higher limit utilisation during these months. Although the sales of this segment were expected to have been impacted during the lockdown period as beaches remained closed, KIL's sales in this segment are typically higher in the second half of a fiscal year, i.e., when the products start reaching the shelves of the retailers. An expected rebound in consumer demand towards H2 FY2021 as the pandemic begins to subside, together with comfortable order inflow from established retail chains such as Target and Walmart, is likely to cushion the overall impact on KIL's sales in the current fiscal.

Liquidity position: Adequate

KIL's liquidity position continues to be **adequate**, with its fund flow from operations being sufficient to meet margin requirements for capex and working capital, as well as the scheduled debt repayment obligations. As on March 31, 2020, the company had estimated unencumbered cash and bank balances of ~Rs. 33 crore, and a cushion of ~Rs. 36 crore in its fund-based bank facilities. Despite a moderation in performance expected in FY2021, along with a possibility of an elongation of working capital cycle amid slower growth, inventory build-up and relaxed credit terms, the liquidity profile is expected to remain comfortable. The same is supported by adequate Lines of Credit (working capital limits stand enhanced to Rs. 175 crore, from Rs. 110 crore earlier), and timely tie-up of long-term funding for ongoing/proposed capex plans. Besides, the liquidity profile continues to be supported by retention of unsecured loans from the promoters (to the extent of ~Rs. 79 crore) in the company.

Rating sensitivities

Positive triggers – ICRA could upgrade KIL's long-term rating if the company achieves a significant growth in scale, supported by increased business from a wider set of customers and geographies, and enhanced product portfolio, while maintaining strong profitability and an efficiently managed working capital cycle, which results in a sustained improvement in its capitalisation and coverage metrics. Specific metrics that could trigger a rating upgrade include TOL/TNW of less than 1.2 times and ROCE of more than 20% on a sustained basis.

Negative triggers – Negative pressure on KIL's rating could arise if there is a sustained pressure on growth and profitability and/ or elongation of 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/ withdrawals of unsecured loans, which together with sizeable capex results in increased dependence on external debt could also trigger a downgrade in ratings. Specific metrics, which could trigger a rating downgrade, include External Debt/OPBDITA of more than 2.0 times and interest cover of less than 4.0 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 financial profile of the company

About the company

Incorporated in 2012 by the Kapoor family and headed by Mr. P. K. Kapoor, KIL is a Panipat (Haryana) based manufacturer and exporter of textile products, like terry towels, bath mats, rugs and bath robes. KIL derives almost its entire revenues from exports, mainly to the US. Besides manufacturing for global value retailers like Target and Walmart, its other global clients include renowned brands like Tommy Hilfiger and Nautica as well.

The company took over the operations, assets and liabilities of the erstwhile partnership firm, Kapoor Industries, at the time of its incorporation in 2012. The erstwhile firm started as a merchant exporter of home furnishings and subsequently set up its manufacturing unit in Panipat. Till 2000, the firm mainly manufactured made-ups from flat fabrics, after which the terry towel mill was set up. Since then, terry towels have been the main revenue driver, and the company has been gradually increasing its production capacities.

Key financial indicators (audited)

	FY2018	FY2019	8M FY2020*
Operating Income (Rs. crore)	584.0	631.4	378.9
PAT (Rs. crore)	33.7	32.9	26.1
OPBDIT/OI (%)	14.5%	14.1%	14.5%
RoCE (%)	24.7%	22.5%	15.7%
Total Outside Liabilities/Tangible Net Worth (times)	2.10	1.68	1.89
Total Debt/OPBDIT (times)	2.05	2.03	3.18
Interest Coverage (times)	6.02	4.92	4.47
DSCR	2.78	2.27	2.33

**provisional*
Source: KIL, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019	FY2018	FY2018
					5-Jun-2020	24-Jan-2020	31-May-2019	No rating action	14-Mar-2018	11-Apr-2017
1	Long-term fund-based bank facilities	Long Term	133.30	69.98*	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	--	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Long-term non-fund based bank facilities	Long Term	0.25	--	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	--	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	Short-term fund-based bank facilities	Short Term	238.75	--	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	--	[ICRA]A1+	[ICRA]A1+
4	Short-term non-fund based bank facilities	Short Term	2.00	--	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	--	[ICRA]A1+	[ICRA]A1+

**Outstanding as on March 31, 2020*
Note: Amounts in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Packing Credit	-	-	-	210.00	[ICRA]A1+
NA	Bank Guarantee	-	-	-	0.25	[ICRA]A+(Stable)
NA	Letter of Credit	-	-	-	2.00	[ICRA]A1+
NA	Derivative Limit	-	-	-	28.75	[ICRA]A1+
NA	Term Loan 1	Dec-15	9.30%	FY2023	6.20	[ICRA]A+(Stable)
NA	Term Loan 2	Aug-16	9.15%	FY2024	8.68	[ICRA]A+(Stable)
NA	Term Loan 3	Dec-13	9.30%	FY2023	1.72	[ICRA]A+(Stable)
NA	Term Loan 4	Apr-17	8.50%	FY2024	19.49	[ICRA]A+(Stable)
NA	Term Loan 5	Mar-18	8.85%	FY2024	8.16	[ICRA]A+(Stable)
NA	Term Loan 6	Mar-19	8.85%	FY2027	23.68	[ICRA]A+(Stable)
NA	Term Loan 7	Feb-19	9.45%	FY2026	4.88	[ICRA]A+(Stable)
NA	Term Loan 8	Feb-20	8.90%	FY2027	29.00	[ICRA]A+(Stable)
NA	Term Loan 9	Feb-20	8.90%	FY2031	30.00	[ICRA]A+(Stable)
NA	Term Loan 10 (Vehicle Loan)	Feb-19	8.65%	FY2024	1.49	[ICRA]A+(Stable)

Source: Kapoor Industries Limited

Annexure-2: 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.

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.

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