

June 24, 2021

## Kapotex Industries Private Limited: Long-term rating upgraded; Short-term rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based-Term Loan	2.28	1.17	[ICRA]BB- (Stable); Upgraded from [ICRA]B+ (Stable)
Fund based- Cash Credit	(1.50) <sup>#</sup>	(1.50) <sup>#</sup>	[ICRA]BB- (Stable); Upgraded from [ICRA]B+ (Stable)
Fund based- Working Capital Facilities	5.00	5.00	[ICRA]A4; Reaffirmed
Non-fund based-Working Capital Facilities	5.60	5.60	[ICRA]A4; Reaffirmed
Unallocated Limits	1.40	2.51	[ICRA]BB- (Stable); Upgraded from [ICRA]B+ (Stable)/ [ICRA]A4; Reaffirmed
<b>Total</b>	<b>14.28</b>	<b>14.28</b>	

\*Instrument details are provided in Annexure-1

<sup>#</sup>Sub limit of Export Packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting facility of Rs. 5.00 crore

### Rationale

The rating upgrade reflects the healthy operating margin of Kapotex Industries Private Limited (KIPL or the company) in the last three fiscals which further improved to 24.72% in FY2021 (provisional) from 16.33% in FY2020 along with favourable capital structure reflected by TD/TNW of 0.46 times (0.77 times in PY20) aided by repayments of term borrowing and subsequent satisfactory interest coverage ratio at 6.02 times (4.14 times in PY20) as on March 31, 2021. The improvement in the operating margin is attributable to higher share of value add products in revenues coupled with sustainable improvement in the cost structure. In addition, the ratings continue to factor in the extensive experience of KIPL's promoters in the wool processing industry and its established customer base along with long standing association with raw wool suppliers ensuring steady supply of wool.

The ratings, however, continue to remain constrained by company's small-scale operations capped by relatively low capacity utilisation levels emanating from intense competition in the international market. Further, the ratings remain constrained by the high customer concentration risk given KIPL's high reliance on a single customer along with its exposure to high geographical concentration risk with bulk of its revenues derived from the US and UK. Further, the company remains dependent on imports for its raw material with long import cycle coupled with high seasonal stocking of raw wool due to cyclicity in availability results in high inventory holding level. This exposes the company to inventory risk due to the volatility in wool prices. Despite natural hedge from imports, ICRA notes that the company's profitability remains exposed to adverse currency movements to some extent.

The Stable outlook emphasis ICRA's opinion that the company will be able to maintain satisfactory profitability metrics in the near term aided by the rising share of value add products in the revenues.

## Key rating drivers and their description

### Credit strengths

**Extensive experience of the promoters in the wool processing business** – KIPL’s promoters have extensive experience in the wool processing industry. This has enabled the company to maintain established relationships with key customers, leading to repeat orders from clients and uninterrupted raw material sourcing arrangements with suppliers. This has also helped the company to sustain its market share in key geographies and swiftly recoup its lockdown losses in the past fiscal, while maintaining a steady business operation.

**Established customer base in the US and UK entail repeat orders** – Over the years, KIPL has developed a strong connect with customers chiefly based in the US and UK which has entailed repeat orders in the past. This apart, the company has a long-standing association with its key customer based in the US who continue to solely contribute over 30% of KIPL’s sales in the last many years.

**Favourable capital structure aided by repayments of term borrowing and subsequent improvement in interest coverage indicator** – KIP’s capital structure has witnessed a steady improvement with moderating gearing levels in the last three fiscal and it remain comfortable at 0.46X as on March 31, 2021. This is attributable to repayment of term debts along with expanding networth base with profit retention. Further, lower working capital borrowing level along with repayment of term debt has resulted in lower interest cost and consequent improvement in interest coverage in FY2021 to 6.02X from 4.14X in FY2020.

**Healthy operating margin supported by increasing share of value add yarn in revenues coupled with improving cost structure** – KIPL’s operating margin witnessed a notable improvement in FY2021 to 24.72% from 16.33% in Fy2020 owing to lower dyeing charges along with rising share of value add products in the total revenues. In last three fiscal the company’s operating margin remain satisfactory owing to it continued focus on value add products in the business.

### Credit challenges

**Small scale of operation; intense competition in global market leading to low capacity utilization level** –KIPL’s scale of operation continue to remain small depicted by an operating income of Rs. 16.80 crore which declined from Rs. 19.72 crore in FY2020 owing to decline in sales volumes emanating from pandemic led disruptions marred by brief factory shutdown and restricted shifts. Also, KIPL’s operating income remained capped in the last many years owing to relatively low capacity utilisation level emanating from intense competition in the international market.

**Vulnerability of margins to price risk emanating from higher inventory level owing to seasonality coupled with long import cycle** – The company remains dependent on imports for its raw material with long import cycle, because of which it has to maintain an adequate inventory level for faster turnaround of its export orders. This apart, due to seasonality in raw wool availability the company is required to undertake seasonal stocking. Given the volatility in the wool prices, high inventory level exposes the company to price risk which leads to volatility in its operating margin.

**High customer and geographical concentration risk** – Traditionally, the US and UK have remained the key markets which together contribute bulk of KIPL’s sales revenues in the past. UK continue to contribute 25-30% of the total sales in the past three fiscals while the US continue to remain the major market solely contributing over 50% of the total sales in FY2021 indicating high geographical concentration risk. This apart, the company’s key customer has been solely contributing over 30% of the total sales in the past many years which indicate high customer concentration risk.

**Susceptibility to foreign exchange risk** – KIPL’s revenue profile has remained export dominated in the last many years. Despite natural hedge from imports, ICRA notes that the company’s profitability remains exposed to adverse currency movements to some extent.

**Seasonal nature of raw wool availability and hence stocking requirement results in high working capital intensity for KIPL; high reliance on LC backed creditor funding** - Owing to cyclicity in availability of wool, the company is required to undertake seasonal stocking. The key raw material (raw wool) is arrived in two varieties one is long staple wool which annually arrives in

August – November and second shear wool arrives starting in December – March. This results in high inventory holding in September and March end due to inventory stocking leading to high working capital intensity in the business. The purchases are backed by LC of 120-180 days thereby resulting in high creditors period.

## Liquidity position: Adequate

KIPL's liquidity remains **adequate**, as evidenced by sizable undrawn working capital limits and sufficient drawing power as on March 31, 2021. The average working capital utilisation of fund-based limits remained moderate at ~75% of the sanctioned limit in the last 12 months. Also, against the debt repayments in the near term, the company is expected to generate adequate net cash accruals from its business, which will be sufficient to cover payment obligations in the near term.

## Rating sensitivities

**Positive factors** –The rating may be upgraded if the company is able to ramp up its scale of operation aided by healthy utilisation of installed capacity alongwith sustained profitability margin along with improvement in working capital intensity.

**Negative factors** – The rating may be downgraded if there is shrinkage in scale of operation, weakening of profitability margin or a stretch in the working capital cycle which materially impacts the liquidity profile. Also, ROCE remaining below 10% could also result in a downward revision in the ratings.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Indian Textile Industry - Spinning</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

## About the company

KIPL was incorporated on May 29, 2008, by Mr. Rajiv Kapur and Mr. Varun Kapur. The company manufactures and exports woollen yarn in the form of worsted spun yarn and carded yarn. The wool yarn manufactured by the company finds application in the manufacturing of rugs, floor coverings and carpets. KIPL's registered office is at Kurla, Mumbai, and its manufacturing unit is at the Gujarat Industrial Development Corporation (GIDC) area of Valsad in Gujarat.

## Key financial indicators (audited)

PVTL	FY2019	FY2020
Operating Income (Rs. crore)	21.35	19.72
PAT (Rs. crore)	2.03	1.23
OPBDIT/OI (%)	17.89%	16.33%
PAT/OI (%)	9.52%	6.25%
Total Outside Liabilities/Tangible Net Worth (times)	1.42	1.18
Total Debt/OPBDIT (times)	2.07	2.54
Interest Coverage (times)	4.33	4.14

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Source: Company, ICRA research

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

### Rating history for past three years

	Instrument	Current Rating (FY2022)			Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2018
					June 24, 2021	May 07, 2020	April 05, 2019	March 07, 2018
1	Term loans	Long-term	1.17	1.17	[ICRA]BB-(Stable)	[ICRA]B+(Stable)	[ICRA]B+(Stable)	[ICRA]B+(Stable)
2	Cash Credit	Long-term	(1.50) <sup>#</sup>		[ICRA]BB-(Stable)	[ICRA]B+(Stable)	[ICRA]B+(Stable)	[ICRA]B+(Stable)
3	Export packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting	Short-term	5.00		[ICRA]A4	[ICRA]A4	[ICRA]A4	[ICRA]A4
4	Letter of Credit/ Bank Guarantee/Credit Exposure	Short Term	5.60		[ICRA]A4	[ICRA]A4	[ICRA]A4	[ICRA]A4
5	Unallocated	Long Term/ Short Term	2.51		[ICRA]BB-(Stable)/ [ICRA]A4	[ICRA]B+(Stable)/ [ICRA]A4	[ICRA]B+(Stable)/ [ICRA]A4	[ICRA]B+(Stable)/ [ICRA]A4

*#Sub limit of Export Packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting facility of Rs. 5.00 crore*

### Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loans	Simple
Cash Credit	Simple
Export packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting	Simple
Letter of Credit/ Bank Guarantee/Credit Exposure	Very Simple
Unallocated	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 analyzing 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, is available on ICRA's website: [Click Here](#)

**Annexure-1: Instrument details**

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Term loans	August 10, 2020	-	FY2025	1.17	[ICRA]BB-(Stable)
NA	Cash Credit		-		(1.50) <sup>#</sup>	[ICRA]BB-(Stable)
NA	Export packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting		NA		5.00	[ICRA]A4
NA	Letter of Credit/ Bank Guarantee/Credit Exposure		NA		5.60	[ICRA]A4
NA	Unallocated		NA		2.51	[ICRA]BB-(Stable)/ [ICRA]A4

**Source:** Company; <sup>#</sup>Sub limit of Export Packing Credit/Packing credit in Foreign Currency/ Export Bill Discounting facility of Rs. 5.00 crore

**Annexure-2: List of entities considered for consolidated analysis – Not applicable**

## ANALYST CONTACTS

**Jayanta Roy**

91 33 7150 1120

[jayanta@icraindia.com](mailto:jayanta@icraindia.com)

**Kaushik Das**

91 33 7150 1104

[kaushikd@icraindia.com](mailto:kaushikd@icraindia.com)

**Srinivas Menon**

91 22 6169 3354

[srinivas.menon@icraindia.com](mailto:srinivas.menon@icraindia.com)

## RELATIONSHIP CONTACT

**Jayanta Chatterjee**

+91 80 4332 6401

[jayantac@icraindia.com](mailto:jayantac@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries

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

[info@icraindia.com](mailto:info@icraindia.com)

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## ICRA Limited



### Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



### Branches



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