

November 11, 2019

Kikani Exports Private Limited: Ratings re-affirmed

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based- Term Loans	104.99	60.00	[ICRA]BB(Stable); re-affirmed
Fund based- Working Capital Facilities	397.00	225.00	[ICRA]A4; re-affirmed
Total	501.99	285.00	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation considers the expected stable performance of KEPL in the current fiscal on the back of its favourable order book position, driven by its established presence in the yarn export segment with improving customer and product diversification. KEPL's performance was steady in FY2019, characterised by a revenue growth of 6% and relatively stable margins. The overall performance was limited by the reduction in export demand in H2 FY2019, which resulted in some order cancellations and consequent lower revenues and earnings. KEPL's revenues and accruals are expected to be supported by its long relationship with key customers, aiding in consistent order inflows and subsidies received. Despite the adverse demand conditions prevalent with yarn exports from India, which contracted by more than 30% in H1 FY2020, KEPL's performance has been consistent with revenues expected to grow by around 2% in FY2020. In addition, KEPL's cash accruals are expected to remain stable at around Rs. 22 crore in FY2020 despite the pressure on earnings faced by the spinning industry. KEPL's operating profits are supported by higher earnings from the trading segment, with the company able to source yarn at favourable rates, given the weak demand and consequent yarn stock pile-ups faced by spinners. However, KEPL's margins in the manufacturing segment have fallen by more than 300 bps, in line with the industry, with yarn prices registering a higher decline than the cotton prices (adjusted for the inventory held). The ratings remain constrained by KEPL's stretched financial profile, characterised by modest coverage indicators and tight liquidity position. Despite the recovery in operating performance in FY2018 and FY2019, post the lows witnessed in FY2017, capitalisation ratios remain stretched owing to the debt-funded capital expenditure incurred in the past and high working capital requirements. Key credit metrics including total debt (including export bills discounted) to operating profits and debt service coverage ratio are likely to remain under pressure, at around 5.5 times and 1.2 times, respectively for FY2020. Free cash flows are expected to remain tight owing to stagnant earnings from operations limited by the industry scenario, capital expenditure incurred for a knitting facility and high repayment obligations. KEPL's earnings remain vulnerable to volatility in cotton prices given the limited pricing flexibility because of intense competition. The ratings also factor in the extensive experience of the promoters in the yarn-trading business and its moderate scale of operations.

The Stable outlook reflects ICRA's expectation that the revenues and earnings of KEPL would remain supported by its established presence with recurring orders received from its stable customer base, despite overcapacity conditions to be faced by the industry in the coming quarters.

Key rating drivers and their description

Credit strengths

Established presence in the yarn export segment – KEPL is an established player in the merchant yarn export market, with presence of more than a decade. The company has moderate scale of operations and is one of the larger yarn exporters in the region. KEPL has a strong customer base and its established relationships with key customers result in repeat orders, as illustrated by a steady order book in the current fiscal despite adverse demand conditions.

Improving customer and product diversification – KEPL’s customer profile has diversified across non-China markets in the recent fiscals, after high dependence on exports to China impacted its performance in FY2017. To improve business diversification and support volume growth, the company has added large customers in India and other key markets in the Far East and Africa. Concentration towards China had reduced from over 60% of revenues in FY2016 to around 15% now. With the increase in sales to the domestic market in the recent quarters, the impact of demand-related risks owing to slowdown in any market is likely to be limited, going forward. KEPL’s wide product range includes combed yarn, carded yarn and specialty yarn in various count ranges in the trading segment.

Credit challenges

Stretched financial profile – The capitalisation ratios of KEPL have remained under pressure owing to moderate earnings from operations and firm debt levels (owing to the debt-funded capital expenditure incurred in the past and high working capital intensity in the business). Key ratios including total debt to operating profits (including export bills discounted) and debt service coverage ratio were at modest levels of 6 times and 1.2 times, respectively for FY2019.

Modest demand and unfavourable input costs to limit earnings growth in FY2020 – Weaker-than-expected export demand since Q3 FY2019 has adversely impacted contribution levels for spinners, with earnings coming under severe pressure, especially in Q2 FY2020. The contribution margins are also constrained by firm cotton prices, as the reduction in yarn realisations has been more than the fiber prices adjusted for inventory held. The overall performance is likely to be supported to some extent by the improved earnings witnessed in the trading division, with availability of yarn at cheaper rates on the back of oversupply conditions prevalent in the market.

Operating margins restricted by relatively low value addition in business – KEPL’s operating margins have been limited over the years, owing to low value addition in the trading segment and its focus on the lower-margin medium counts. KEPL operates in a highly competitive and commoditised spinning industry, characterised by minimal product differentiation and fragmented nature, which restricts its pricing flexibility. The same exposes earnings to fluctuations in cotton prices as witnessed in H1 FY2020. Proposed expenditure towards establishing a knitting unit is expected to improve value addition and margins to some extent over the medium term.

Liquidity position: Stretched

KEPL’s free cash flows were strained in FY2019 because of lower-than-expected earnings generated in H2 FY2019, incremental working capital requirements and high repayment obligations. The average utilisation of its packing credit limits remained high against its drawing power. KEPL’s liquidity position is expected to remain tight in FY2020, limited by the ongoing capital expenditure for its knitting unit, high repayment obligations and pressure on earnings growth on the back of tepid demand conditions.

Rating sensitivities

Positive triggers

ICRA may upgrade KEPL's ratings if the company demonstrates a steady improvement in its liquidity position and coverage indicators. Specific metrics that may lead to an upgrade of KEPL's rating include (1) fund-based utilisation improving to lower than 90% of drawing power on a sustained basis; and (2) debt service coverage ratio greater than 1.4 times on a sustained basis.

Negative triggers

Negative pressure on KEPL's ratings may arise if, for reasons including weak demand conditions or a rise in debt-funded capital expenditure, the Total outside liabilities (including export bills discounted) to tangible net worth exceeds 5.5 times on a sustained basis. A weakening in DSCR to below 1.1 times may also exert negative pressure on the company's ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Indian Textile Industry - Spinning
Parent/Group Support	Not applicable
Consolidation	Not applicable

About the company

Incorporated in 2001, Kikani Exports Private Limited (KEPL) is involved in merchant export of cotton yarn from India. KEPL is closely held by the promoter and his family members. The company sources cotton yarn from established mills located across India and supplies to its various customers spread across Far East, Middle East, Africa, Europe, China and South America. The company established a spinning unit with an installed capacity of 30,000 spindles in Gujarat in FY2016. The unit produces compact medium count cotton yarn targeting customers across both the domestic and export markets.

Key financial indicators

	FY2018	FY2019
Operating Income (Rs. crore)	694.7	734.1
PAT (Rs. crore)	3.7	3.7
OPBDIT/OI (%)	6.0%	5.4%
RoCE (%)	7.0%	7.8%
Total Outside Liabilities*/Tangible Net Worth (times)	7.9	6.5
Total Debt*/OPBDITA (times)	5.8	6.0
Interest coverage (times)	2.4	2.0
DSCR	1.3	1.2

*Note: Total outside liabilities and total debt levels considered include export bills discounted with banks

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Current Rating (FY2020)				Chronology of Rating History for the past 3 years			
	Type	Amount Rated	Amount Outstanding	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2017	Date & Rating in FY2016	
1 Fund based-Term Loans	Long Term	60.00	60.00	11-Nov 2019 [ICRA]BB (Stable)	03-May 2018 [ICRA]BB (Stable)	31-Jan 2017 [ICRA]BB (Stable)	15-Sep 2015 [ICRA]BB (Stable)	
2 Fund based-Working Capital Facilities	Short Term	225.00	-	[ICRA]A4	[ICRA]A4	[ICRA]A4+	[ICRA]A4+	

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 www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based- Term Loans	FY2015	-	FY2024	60.00	[ICRA]BB(Stable)
NA	Fund based- Working Capital Facilities	-	-	-	225.00	[ICRA]A4

Annexure-2: List of entities considered for consolidated analysis

Not applicable

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