KG Petrochem Limited

July 23, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facilities: Term Loan	92.65	81.97	[ICRA]BBB (Stable); reaffirmed
Long-term fund-based bank facilities: Working Capital	21.00	17.00	[ICRA]BBB (Stable); reaffirmed
Long Term non-fund-based bank facilities	5.00	5.00	[ICRA]BBB (Stable); reaffirmed
Unallocated bank facilities	0.00	5.08	[ICRA]BBB (Stable); reaffirmed
Short-term fund-based bank facilities: Working Capital	43.20	52.80	[ICRA]A3+; reaffirmed
Total	**161.85**	**161.85**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]BBB (pronounced ICRA triple B)[1] for the Rs. 109.05-crore[2] (reduced from Rs. 118.65 crore earlier) fund-based, non-fund-based and unallocated bank facilities of KG Petrochem Limited (KGPL). The outlook on the long-term rating continues to be Stable. ICRA has also reaffirmed the [ICRA]A3+ (pronounced ICRA A three plus) rating for the Rs. 52.80-crore (enhanced from Rs 43.20 crore earlier) short-term fund-based bank facilities of KGPL.

Rationale

The rating reaffirmation factors in KGPL's steady operational and financial risk profile. The company's ability to get repeat business from an established client base supports its capacity utilisation levels, which together with access to fiscal incentives and limited debt repayment obligations, facilitates comfortable debt coverage metrics. Although the company is undertaking a debt-funded Greenfield project in a new line of business (artificial leather), ICRA expects its capitalisation and debt coverage indicators to remain comfortable, supported by healthy surplus generation from its existing line of business.

Further, while reaffirming the ratings, ICRA has taken note of the headwinds faced by the industry in terms of unfavourable demand trends in key export markets and short-term domestic challenges emanating from the transition to the Goods and Services Tax (GST) regime and interim changes in export incentives, which constrained growth in the company's turnover during FY2018. Although stagnancy in turnover together with increased power cost, resulted in moderation in operating profitability during the year, the overall credit profile remained steady as reflected by a debt service coverage ratio (DSCR) of ~1.5 times and interest cover (operating profit before interest, tax, depreciation and amortisation (OPBDITA)/ interest cost) of ~5.4 times in FY2018. Further, despite a change in payment terms with key buyers, which resulted in increased working capital intensity, the company's liquidity profile remained comfortable.

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[1] *For complete rating definition please refer to ICRA Website www.icra.in or any of the ICRA Rating Publications*

[2] *Rs. 1 crore = Rs. 100 lakh = Rs. 10 million*

The ratings, however, continue to be constrained by geographic concentration risks, further heightened by dependence on few key buyers. The ratings also continue to be constrained by the execution, financing and marketing risks associated with the company's ongoing expansion programme. Although the presence of experienced promoters and a professional management team and their demonstrated track record in project execution and commissioning provides comfort, KGPL's ability to profitably scale up its operations in a new segment, remains to be seen. In this context, ICRA draws comfort from the company's plan of phasing out further incremental capex over a two-year period, while taking adequate time to stabilise the recently installed capacities.

In ICRA's view, KGPL's ability to sustain healthy capacity utilisation in its existing operations, scale up operations in the new segment and prudently manage risks arising from volatility in raw material prices as well as fluctuations in exchange rates will remain pertinent for a stable credit profile. Besides, timely receipt of fiscal benefits, adequate and timely debt tie-up for incremental capital expenditure and efficient management of working capital, remains imperative for a comfortable liquidity profile and hence will be a key rating sensitivity.

Outlook: Stable

ICRA expects KGPL's credit profile to remain Stable, supported by steady performance of the terry towel segment and comfortable ramp up in operations of the new unit. The outlook may be revised to Positive if the company is able to achieve higher than estimated growth in revenues and profitability, supported by an effective ramp up of the new unit, as well as sustainable improvement in working capital cycle, which strengthens its financial risk profile. The outlook may be revised to Negative if there is a significant delay in ramp up of operations in the new segment or pressure on performance of existing segment, resulting in weaker than estimated debt coverage metrics. Moreover, inadequate or a delayed tie-up of debt for the proposed expansion, significantly higher than indicated capital expenditure or a stretched working capital cycle, can also result in a pressure on company's liquidity profile and would warrant a revision in outlook to negative.

Key rating drivers

Credit strengths

Track record of repeat business from an established client base - KGPL has been a manufacturer and exporter of terry towels since FY2006, with exports accounting for ~85% of its revenues. Over the years, the company has established relationships with reputed customers like Wal-Mart and Saturday Knight in the export markets who have been providing it with repeat business. During FY2018, the company faced multiple headwinds including unfavourable demand trends in the key export markets as well as short-term domestic challenges from the transition to the GST regime and interim changes in export incentives. This together with a change in composition of product portfolio resulted in a volumetric de-growth and a decline in capacity utilisation to ~71% in FY2018, from ~80% achieved in FY2016 and FY2017. The decline was, however, cushioned to some extent by continued orders from the company's existing customers which kept the capacity utilisation reasonable vis-a-vis 5-year average level of ~75%. It is pertinent to note here that optimum level of capacity utilisation for the company is ~80%, which is the level typically achievable after adjusting for operating constraints like smaller order sizes and change-over times.

Eligibility for fiscal incentives, which lowers finance costs and supports the financial profile - Access to fiscal incentives in the form of capital and interest subsidies under the capital investment scheme of the Rajasthan State Government as well as the Technology Upgradation Fund Scheme (TUFS) of the Government of India, lowers the average finance cost for the company. Together with moderate debt repayment obligations, this translates into comfortable debt coverage indicators; as reflected by DSCR at ~1.5 times and interest cover of more than 5.0 times.

Satisfactory liquidity profile - Supported by healthy surplus generation from operations and adequacy of long-term sources of funding, KGPL has maintained a satisfactory liquidity profile over the years. Although KGPL reported an increase in working capital intensity during FY2018 owing to higher receivables, due to change in payment terms by its key buyers and delay in getting Government dues (GST refunds and export incentives), its liquidity profile remained comfortable as reflected by the average utilisation of ~73% of drawing power during the year.

Timely commissioning of the first phase of Greenfield expansion in artificial leather segment; unit to provide diversification benefits - The company is nearing completion for the first phase of its capital expenditure plan for venturing into the artificial leather segment. The said capex has been completed without significant delays and within the estimated costs. Although risks pertaining to successful commissioning/ ramp up and launch of second phase in FY2020 remain, timely completion of the first phase provides comfort. The company's venture into this segment is expected to drive the business growth over the next two to three years, while providing product as well as geographic diversification benefits, as the company intends to focus on the domestic market for this segment.

Credit challenges

Modest return indicators – While a gradual shift in focus towards more value-added towel segments (printed and embroidered) supported KGPL's profitability between FY2015 and FY2017, these benefits are partially offset by smaller order sizes and higher operating leverage, which affects the asset turnover and hence return on capital indicators for the company. This is reflected by a moderate ROCE of ~12.9% for FY2017, which further moderated to ~9% in FY2018 due to pressure on profitability and increased debt levels, owing to higher working capital requirements.

Exposure of profitability to risks arising from volatility in raw material prices, demand in key export markets, revisions in export incentives and foreign exchange fluctuations - With raw material costs accounting for ~45% of the sales value and there being a lag between order-booking and deliveries, KGPL's profitability remains vulnerable to volatility in the prices of its key raw material, viz., cotton yarn. Besides, reliance on exports also makes the company's performance vulnerable to slowdown in demand in key export markets, revisions in export incentives, competitive pressures from other competing nations besides domestic peers and to foreign exchange fluctuation risks. The ability of the company to prudently manage these risks remains critical for sustaining strong profitability.

High geographical and client concentration risks – The company has high dependence on the US and Chilean markets for its exports, with the company deriving ~80% of its revenues from these countries. The risk is further heightened by dependence on a few key buyers (sales to top five customers account for ~60-70% of total export sales). Any change in demand patterns by any of the major customers or adverse developments in the key countries of export can directly impact the operating performance.

Increasing working capital intensity – KGPL's working capital intensity, as reflected by Net Working Capital/ Operating Income (NWC/ OI), has increased to ~42% in FY2018 from ~25% prior to FY2015, primarily owing to an increase in receivable turnover period. In addition, delays in getting GST refunds and export incentives also resulted in an increase in working capital requirements during FY2018. Although the company's liquidity profile has remained satisfactory, a further material increase in working capital intensity can affect its liquidity profile. Further, the company's ability to manage working capital in the artificial leather segment, which is scheduled to become operational during FY2019, together with timely tie-up of adequate working capital limits for the same, would be imperative for a comfortable liquidity profile.

Operational, marketing and financing risks associated with the new project – Having operated in the terry towels segment since commencement of operations, company's venture into the artificial leather segment with the Greenfield project under implementation, marks its entry into a new area of operations. The company's ability to stabilise the operations in the new segment and gain a foothold in a highly fragmented market with large number of unorganised players remains to be seen. Further, the ability to scale up its operations and the timely availability of enhanced working capital limits and long-term debt for meeting the future capex plans of the artificial leather segment remains crucial.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology
Rating Methodology for Entities in the Indian Textiles Industry- Fabric Making

About the company:

Established in 1980, KG Petrochem Limited (KGPL) is a listed company with 74.65% shareholding held by the promoters, Mr. Gauri Shanker Kandoi and family. KGPL ventured into the manufacturing of terry towels in December 2005 and has in-house weaving, printing, designing and embroidery facilities, with the terry towel segment accounting for 97% of the Operating Income (OI). At present, KGPL has an installed capacity of 6,200 MTPA with 100 looms. The company also works as a consignment stockiest of GAIL (India) Limited for polymers in Rajasthan under its agency division.

KGPL is also venturing into the manufacturing of artificial leather, for which a capital expenditure of ~Rs. 41 crore is being undertaken in the first phase. After commissioning the first phase and stabilising the unit during FY2019, the company proposes to undertake the second phase of the expansion in FY2020.

During FY2018, KGPL reported an Operating Income (OI) of ~Rs. 231 crore and Profit After Tax (PAT) of Rs. 7.82 crore against an OI of Rs. 229 crore and PAT of Rs. 10.02 crore in FY2017.

Key financial indicators (Audited)

	FY2017	FY2018
Operating Income (Rs. crore)	228.92	230.93
PAT (Rs. crore)	10.02	7.82
OPBDIT/OI (%)	14.8%	12.1%
RoCE (%)	13.32%	8.98%
Total Debt/TNW (times)	2.28	2.21
Total Debt/OPBDIT (times)	3.44	4.69
Interest coverage (times)	5.91	5.37

Source: KGPL's Annual Reports/ Financial Statements, ICRA research

Status of non-cooperation with previous CRA:

CARE suspended the CARE BBB-/ A3 rating outstanding for the Rs. 140.86-crore bank facilities of KGPL in December 2016. The suspension reflected CARE's inability to maintain a valid rating in the absence of any information from the company.

Any other information: The financials for FY2018 have been reported as per IndAS, and accordingly, previous year financials have been restated.

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating Jul-2018	Date & Rating in FY2018 Jul-2017	Date & Rating in FY2017 Jun-2016	Date & Rating in FY2016 -
1	Fund-based bank facilities (Term Loan)	Long Term	81.97	71.44	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
2	Fund-based bank facilities (Working Capital)	Long Term	17.00	--	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
3	Non-fund-based bank facilities	Long Term	5.00	--	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
4	Unallocated bank facilities	Long Term	5.08	--	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
5	Fund based-Working Capital	Short Term	52.80	--	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	-

*Amount outstanding as on March 31, 2018

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 / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Cr)	Current Rating and Outlook
NA	Term Loan-1	March 19, 2018	9.65%	FY2024	16.45	[ICRA]BBB (Stable)
NA	Term Loan-2	March 19, 2018	9.65%	FY2020	4.29	[ICRA]BBB (Stable)
NA	Term Loan-3	March 19, 2018	9.65%	FY2020	0.83	[ICRA]BBB (Stable)
NA	Term Loan-4	March 19, 2018	9.65%	FY2023	2.13	[ICRA]BBB (Stable)
NA	Term Loan-5	March 19, 2018	9.65%	FY2024	27.52	[ICRA]BBB (Stable)
NA	Term Loan-6	May 08, 2017	9.20%	FY2026	30.75	[ICRA]BBB (Stable)
NA	Cash Credit	March 19, 2018	NA	NA	17.00	[ICRA]BBB (Stable)
NA	Export Packing Credit/ Stand-by Line of Credit	March 19, 2018	NA	NA	52.80	[ICRA]A3+
NA	Bank Guarantee	March 19, 2018	NA	NA	5.00	[ICRA]BBB (Stable)
NA	Unallocated bank facilities	NA	NA	NA	5.28	[ICRA]BBB (Stable)

Source: KG Petrochem Limited

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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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