October 04, 2019

Kitex Garments Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loans	5.34	3.31	[ICRA]AA-(Stable); reaffirmed
Fund-based - Working Capital Facilities	117.00	117.00	[ICRA]A1+; reaffirmed
Non-fund Based-Working Capital Facilities	20.00	20.00	[ICRA]A1+; reaffirmed
Unallocated facilities	37.68	39.71	[ICRA]AA-(Stable)/[ICRA]A1+; reaffirmed
Total	**180.02**	**180.02**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the ratings, ICRA has consolidated the business and financial risk profiles of Kitex Garments Limited (KGL) and Kitex Childrenswear Limited (KCL and hereafter collectively referred to as the Group), owing to the common management and strong operational linkages.

The re-affirmations of ratings reflect the strong operating and financial performance of the Kitex Group in FY2019, and the expected consistent performance over the coming quarters on the back of its continued robust order book position. The Group witnessed revenue growth of more than 25% in FY2019, driven by a combination of healthy growth in volumes supplied to its top three customers and better realisations with a shift in the product portfolio towards more value-added garments. Consistent growth in order inflows from existing large customers and addition of new customers are likely to drive volume growth of around 15% per annum over the medium term, backed by its strong market presence in the infant wear segment. Operating margins are also likely to remain stable at around 25%, supported by its integrated manufacturing setup with a high level of automation and strong operating efficiencies. This improvement in performance since H1 FY2019 follows a period of modest returns witnessed in FY2017 and FY2018, when revenues and earnings were under pressure owing to a loss of business from a few customers, slowdown in order inflows from other key customers and reduction in export incentives in FY2018 amid rising operating costs.

The ratings continue to derive comfort from the Group's strong financial profile, characterised by a conservative capital structure with healthy coverage metrics and comfortable liquidity position. ICRA notes that the Kitex Group is in the process of adding significant capacities across the value chain including knitting, processing and garmenting to meet increasing order requirements and improve the extent of value addition in its business. The proposed cumulative capital expenditure plan is worth Rs. 910 crore during FY2019 to FY2025, of which around Rs. 100 crore has been incurred till the end of August 2019, primarily towards land acquisitions. Despite the large size of the envisaged expansion, the Group's dependence on external debt is likely to be limited because of its expected healthy earnings from operations. The Group's cash accruals are expected to remain more than Rs. 175 crore per annum during the said period, which would result in its Total Debt to Tangible Net Worth (TD/TNW) and Total Debt to operating profits (TD/OPBDITA) not exceeding 0.25 times and 0.75 times, respectively during the tenure of the expansion. The ratings, however, continue to factor in the company's high customer and geographical concentration risks (which had impacted performance in the past), with its top three customers contributing more than 90% to its overall revenues. Nevertheless, revenues from new customers are expected to improve going forward, with concentration towards its major customers expected to reduce gradually over the medium term. The company is also exposed 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 with established buyers.

The Stable outlook reflects ICRA's expectation that the operational and financial performance of the Kitex Group will continue to benefit from its established presence in the industry, robust order book position aided by repeat orders from key customers, strong operating efficiencies and healthy capitalisation levels, despite the large capital expenditure program envisaged by the Group.

Key rating drivers and their description

Credit strengths

Established presence in the infant wear export segment -- The Kitex Group is among the largest manufacturers and exporters of infant wear globally, with a demonstrated track record and strong market position. The promoter's extensive experience in the industry, long relationship with leading brands in the US market and limited domestic competition have supported revenues and earnings over the years.

Strong order book position -- Post the modest performance in FY2017 and FY2018, the Group's performance has improved in the recent quarters driven by a steady growth in volumes and realisations. With the order book position remaining at healthy levels at the end of September 2019, volumes are likely to witness a continued stable growth of around 15% per annum over the medium term. The expected shift in sourcing by large retailers from competing supplier nations to India owing to issues related to compliance and quality among others are likely to support the long-term growth potential of the company.

Integrated manufacturing facility -- The company has presence across knitting, processing and garmenting segments of the value chain, enhancing operational efficiencies. Besides, presence in the value-added segment (printing and embroidery), growing levels of automation and strong operational infrastructure to meet stringent quality requirements resulted in better-than-average industry margins for the Group.

Healthy financial profile -- The Kitex Group continues to enjoy strong financial flexibility, backed by its conservative capital structure with healthy coverage metrics and cash reserves held on the back of consistent earnings from operations generated over the years. Despite the large capital expenditure plan proposed for the period FY2020 to FY2025, an expected steady growth in earnings is likely to limit dependence on external debt and support the credit profile of the Group.

Credit challenges

High customer concentration -- The top three customers of the Group continue to contribute a major portion to the volumes, which exposes revenues to the performance of its key customers, as seen in the past. The risk is mitigated to an extent by the established relationship enjoyed with its existing clientele, reflected in the repeat business generated over the years. Further, the Group has increased its focus towards new customer additions to reduce dependence on its top three customers, with the new buyers likely to contribute around 15% to revenues by the end of FY2021.

Limited pricing power -- The company has limited pricing power with established customers, which exposes its earnings to fluctuations in raw material prices and exchange rates. Pressure on average product realisations against firm operating costs, coupled with reduction in export incentives had constrained the Group's operating margins in FY2018. Nevertheless, an increase in product prices driven by a shift in the product portfolio, improving economies of scale and better contribution levels have supported recovery in margins in the recent quarters. The trend is expected to sustain over the medium term.

Proposed large capacity expansion programme -- The Group has initiated a large expansion plan in FY2019 towards enhancement of capacities across the value chain. A total amount of around Rs. 910 crore is expected to incurred during FY2019 to FY2025, of which around Rs. 100 crore has been incurred till date, funded by internal accruals and cash reserves. The project in the nascent stage of development and the same exposes earnings to execution related risks as any major time or cost overrun may adversely impact the profitability. However, the promoter's long experience and the company's track record of executing similar projects in the past (albeit at a small scale) provide some comfort. Further, the extended timeframe for completion of the project with the expansion to be undertaken only in stages also buffers the risk to an extent.

Liquidity position: Strong

The liquidity position of the Kitex Group has remained strong (with cash balance of Rs. 155 crore as on March 31, 2019), despite an increase in working capital requirements and capital expenditure incurred in the recent quarters. The funding requirements have been met with healthy cash accruals and unutilised lines of credit, with cumulative additional long-term debt drawn over the last two fiscals limited to less than Rs. 10 crore. The average utilisation of its working capital facilities was at around 70% over the last 12 months ending August 2019. Further, the Group is in the process of enhancing its working capital facilities by around Rs. 50 crore to support the incremental working capital requirements given the growing scale of operations. While the planned capital expenditure could reduce the quantum of free cash flows generated, strong earnings from operations (expected cash accruals of more than Rs. 175 crore per annum over the medium term) and cash reserves held are likely to support the liquidity position of the Group.

Rating sensitivities

Positive triggers

The Kitex Group's long-term rating may be upgraded if the scale of operations and earnings continue to register a consistent growth on a sustained basis to further enhance its competitive position, and the business profile becomes more diversified with new customer additions across geographies.

Negative triggers

Negative pressure on the Kitex Group's ratings may arise if, for reasons including lower-than-expected earnings or higher-than-anticipated capital expenditure, its Total Debt/OPBITDA exceeds 1 times on a sustained basis. Any loss of business from its key customers, which would adversely impact its business profile may also exert negative pressure on the Group's ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities operating in the Apparel Industry
Parent/Group Support	NA
Consolidation	For arriving at the ratings, ICRA has consolidated the financials of its Group companies (details as mentioned in Annexure-2), owing to the common management and strong operational linkages between the companies which are into the similar lines of business

About the company

Kitex Garments Limited was incorporated in 1992 and is managed by Mr. Sabu Jacob. The company is a part of the larger Anna-Kitex Group, which has diversified interests in aluminium vessels, home appliances, spice trading and textiles. KGL, along with its group company KCL (which holds a 15.6% stake in the company), manufactures and exports infant wear to apparel retailers based out of the US and other developed markets. The company has a fully integrated manufacturing facility at Kizhakkambalam (Kerala) with a facility to manufacture more than 3 lakh pieces per day. To diversify its business profile and reduce dependence on its key customers, the Kitex Group established a marketing and design unit based out of the US in FY2015 (equally held by KGL and KCL).

Key financial indicators

Particulars (in Rs. Crore)	Kitex Group Consolidated	
Fiscal	**FY2018**	**FY2019**
Operating Income (Rs. crore)	664.0	838.3
PAT (Rs. crore)	72.6	126.7
OPBDIT/OI (%)	21.7%	26.0%
RoCE (%)	17.4%	26.5%
Total Outside Liabilities / Tangible Net Worth (times)	0.3	0.5
Total Debt/OPBDITA (times)	0.3	0.7
Interest coverage (times)	14.6	31.0
DSCR	5.6	9.6

Note: KGL FY2019 financials are audited and KCL figures are provisional; Source: KGL and KCL

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 (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 04-Oct 2019	Date & Rating in FY2019 31-Dec 2018	Date & Rating in FY2018 06-Oct 2017	Date & Rating in FY2017 31-Aug 2016
1	Term Loan	Long Term	3.31	3.31*	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Fund-based - working capital facilities	Short term	117.00	-	**[ICRA]A1+**	**[ICRA]A1+**	[ICRA]A1+	[ICRA]A1+
3	Non-fund based working capital facilities	Short term	20.00	-	**[ICRA]A1+**	**[ICRA]A1+**	[ICRA]A1+	[ICRA]A1+
4	Unallocated	LT/ST	39.71	-	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+

**Outstanding as on March 31, 2019; Source: KGL*

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	Term Loan 1	July-2017	NA	Mar-2022	3.31	[ICRA]AA-(Stable)
NA	Export packing credit and foreign bills discounting	-	-	-	117.00	[ICRA]A1+
NA	Letter of Credit & Bank Guarantee	-	-	-	20.00	[ICRA]A1+
NA	Unallocated	-	-	-	39.71	[ICRA]AA-(Stable)/ [ICRA]A1+

Source: KGL

Annexure-2: 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 Childrenswear Limited	-	Full Consolidation
Kitex USA LLC (note 1)	50%	Equity method
Kitex Herbals Limited (note 2)	-	Full Consolidation
Kitex Infantwear Limited (note 2)	-	Full Consolidation
Kitex Apparels Limited (note 2)	-	Full Consolidation

Note 1 - Kitex USA LLC is a 50:50 joint venture between KGL and KCL
Note 2 – These entities are wholly-owned subsidiaries of KCL
Source: KGL

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