May 26, 2020

Bhartiya International Limited: Ratings reaffirmed; outlook on long-term rating revised from Stable to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – fund-based facilities	36.23	36.23	[ICRA]BBB+(Negative); reaffirmed, outlook revised from Stable to Negative
Short-term – non-fund-based facilities	157.45	157.45	[ICRA]A2; reaffirmed
Long-term/ Short-term – fund-based/non-fund based facilities	360.00	360.00	[ICRA]BBB+(Negative)/[ICRA]A2; reaffirmed, outlook on long-term rating revised from Stable to Negative
Total	**553.68**	**553.68**	

**Instrument details are provided in Annexure-1*

Rationale

The outlook revision on Bhartiya International Limited's (BIL) long-term rating, from Stable to Negative, factors in an expected moderation in its credit profile owing to demand disruptions in the retail segment caused by the spread of the Covid-19 pandemic. Widespread temporary store closures and potential slowdown in consumer discretionary spending across markets is likely to result in a contraction in demand for the company's products in FY2021. ICRA notes that despite demand-side pressures in India's leather garment exports to its key markets in recent years, BIL sustained a modest growth in its revenues (YoY growth of ~6% in FY2019), while also reporting an improvement in its operating margins (operating margins improved from ~7.1% in FY2018 to ~8.7% in FY2019 and remained steady in 9M FY2020 on a YoY basis) which reflects favourably on its operational strengths and strong positioning in the market as a leading exporter of leather garments in the country. However, the pressure on demand is severe and widespread owing to Covid-19 pandemic. Amid these challenges, as lockdowns across several regions are getting lifted, BIL has also resumed partial operations at its factories and is taking several costs saving measures to maintain profitability and preserve cash. Further, ICRA has taken a note of a pickup in the company's order inflow, after a slowdown in the recent months amid lockdowns. Together with expectations of a further recovery in demand in H2 FY2021, and seasonality in BIL's revenues wherein Q2 and Q3 for a year account for ~60% of sales owing to seasonal demand for leather apparels, these are expected to soften the intensity of the impact on its sales and profit margins. Nevertheless, BIL's coverage metrics are likely to witness a moderation from the earlier envisaged levels owing to its high dependence on debt. BIL's manufacturing operations are highly working capital-intensive, given the seasonality inherent in its key segment (viz. leather garments), a long operating cycle, integrated operations (leather tannery as well as garmenting) and a multi-location manufacturing base. With heightened liquidity challenges amid the pandemic, the possibility of a stretch in working capital cycle owing to extended credit period to buyers, and potential inventory build-ups amid deferment of orders cannot be ruled out. In this context, ICRA notes the recent tie-up of an additional Rs. 50-crore line of credit (term loan) which is likely to help BIL withstand the near-term liquidity challenges.

Further, the ratings continue to factor in BIL's strong operational profile characterised by its long and successful operating history of more than two decades and integrated nature of its operations across designing, manufacturing and marketing activities. Besides, its experienced promoters and a professional management team has facilitated establishment of a large base of active and reputed clientele, providing it repeat business. However, the rating continues to be constrained by the company's high dependence on the leather segment as well as high client and geographical concentration risks. The leather segment remains exposed to industry risk arising from waning consumer preference for animal skins, as well as growing protests against their use. Being an export-oriented company, BIL is also exposed to foreign exchange risk. The risk is, however, partly mitigated by a natural hedge, given its import requirements as well as its policy of entering into forward contracts for a part of the exposure, which has helped the company report steady profitability over the years.

ICRA notes that BIL did not honour its scheduled payment obligations falling due in March and April 2020, for some of its bank facilities, as it had sought a moratorium on payments from its lenders as a part of the Covid-19 - Regulatory Package announced by the Reserve Bank of India (RBI) on March 27, 2020. BIL had surplus bank/liquid balances of ~Rs 30 crore as on March 31, 2020 on a standalone basis, which were adequate to service its debt obligations for March and April 2020, in entirety. However, the company availed the said moratorium to conserve cash amid Covid-19 led uncertainties on timing of expected cash inflows.

Despite the missed payment and despite the absence of a formal approval from all the lenders allowing for a payment relief, ICRA has not recognised this instance as a default as of now. This is based on ICRA's expectation that a formal approval for rescheduling the loan would be received in due course, as permitted by the RBI as part of the relief measures announced recently. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020. It may however be noted that if the lenders do not approve of the moratorium in due course, ICRA would review the above stance on default recognition.

Key rating drivers and their description

Credit strengths

Extensive operating history in the leather apparel business, with an established track record of attracting repeat business from export markets - BIL is one of the largest exporters of leather apparels from India, deriving its revenues mainly from the export of leather products (more than ~85% of its standalone revenues) such as apparels, accessories and finished leather. It has a vast operating history of over two decades in the leather apparel business. Over the years, the company has established a strong customer base of reputed international entities such as All Saints, Esprit, Levis Strauss and Okaidi, which has been providing repeat business. Its ability to attract repeat business, together with the addition of new renowned customers like Coach, Chloé, Ralph Lauren and Reiss in recent years, reflects favourably on its operations.

Strong operational profile - BIL runs integrated operations in the leather segment with in-house designing, tannery and manufacturing facilities. Further over the years, the company has focused on diversifying its operations across related product categories (by adding categories such as accessories, textile apparels, PU leather products, finished leather and outerwear etc.) as well as customers and geographies (increasingly focusing on the US and Asian markets). This has helped the company reduce its dependence on European markets to some extent, as reflected in Europe's share in its consolidated revenues declining to an estimated ~60% in FY2019 from ~82% in FY2014.

Experienced promoter group, supported by professional management team – BIL's promoter, Mr. Snehdeep Agarwal has over two decades of relevant experience in the leather product manufacturing and export business, which has helped the company establish a strong customer base over the years. The promoter group is actively involved in the operations of the company and is supported by a professional management team for heading various operational roles such as sales and marketing, designing, procurement and finance.

Credit challenges

Stretched operating cycle; entails high reliance on working capital borrowings- Given the integrated nature of operations, multi-location manufacturing base, seasonal availability of raw leather and intense competition from other bulk buyers of leather in the international markets, the company needs to maintain a high raw material (leather) inventory to ensure smooth production throughout the year. In addition, its need to procure similar quality leather for large customised orders and stock them adequately for the next year's estimated order book, also keeps its inventory holding requirements high. Although BIL reported a correction in the receivable turnover period in FY2019, resulting in reduction in gross working capital cycle (GWC) to 300 days in FY2019 from ~318 days in FY2018, the same continues to be high. Further, BIL has been taking various steps to reduce the GWC, including increased focus on the finished leather segment to optimise inventory levels, and faster conversion of receivables (from factoring arrangements). However, any tangible improvement on account of these is unlikely in the near-term as it contends with the impact of the pandemic. On the contrary, with heightened liquidity challenges at the customers' end, the possibility of a further stretch in working capital cycle owing to extended credit period to buyers, and potential inventory build-ups amid deferment of orders cannot be ruled out. ICRA notes that the risk of inventory obsolescence for raw material stocks remains low given the long shelf life of tanned leather.

High dependence on debt, together with pressures on performance to result in moderation in debt servicing indicators- An increase in working capital intensity resulted in an increase in debt outstanding in the books of the company to around Rs. 430 crore as on March 31, 2020 from Rs. 387 crore as on March 31, 2019. While a corresponding improvement in profit margins, is estimated to have kept the company's debt coverage metrics range-bound, as reflected in an interest cover of more than 2.0 times and DSCR at more than 1.5 times in FY2020E, these remain moderate. Going forward, besides the pressures being witnessed on performance in the current fiscal, increasing repayment obligations owing to the incremental debt availed in the recent years (~Rs 27.5 crore term loan in its subsidiary in FY2019, and ~Rs. 50-crore term loan in the company's own balance sheet in the current fiscal) with a ballooning repayment structure (repayments scheduled to increase from FY2022 onwards) are likely to put further pressure on the debt servicing indicators. ICRA expects company's debt coverage metrics to remain adequate over the next two years (FY2021 and FY2022), despite moderation. However, scaling up of operations, while maintaining/ improving profitability, will remain crucial thereafter to maintain comfortable debt coverage metrics, given the sizeable repayment obligations from FY2023 onwards.

Continued high geographic and customer concentration risk lead to susceptibility of revenues to demand trends in key markets, intense competition from international suppliers and risk of changing preferences - Although the company's increased focus on Asian and American markets is facilitating gradual diversification in its regional presence, Europe still accounts for ~60% of BIL's revenues, exposing it to the risk from adverse regional development as well as change in demand trends in these markets. ICRA notes that within Europe, BIL's presence is diversified across several countries. Further, BIL's top five customers account for more than ~40% of its consolidated sales. Nevertheless, it remains exposed to industry risks such as intense competition from international suppliers, waning consumer preference for animal skins, as well as growing protests against their use.

Vulnerability of profitability to foreign exchange fluctuations and regulatory risks - Being an export-oriented entity, BIL remains exposed to currency risks on account of fluctuations in foreign currency movements. Though the forex risk is mitigated to some extent by its natural hedge from imports and the use of foreign currency in its working capital limits as well as the company's hedging policy of using forward contracts, the same remains vulnerable to the management's discretion. Moreover, revenues and profitability remain susceptible to regulatory risks such as changes in duty structure and rate of export incentives, which could potentially impact the competitiveness of its products.

Liquidity position: Stretched

BIL's liquidity position is stretched owing to its working capital intensive nature of operations, as reflected by its consistently high utilisation of sanctioned fund-based working capital limits, averaging at more than 95% in FY2020E. ICRA expects the recent sanction of additional bank funding as well as extended credit period from suppliers to help BIL withstand the immediate liquidity challenges and build a liquidity cushion amid curtailed operations and likely operational delays in receiving payments. However, timely disbursement of the incremental term loan remains crucial. ICRA has noted that the documentation for the said term loan programme is in progress, and the disbursal is likely to happen shortly. Apart from the immediate cushion available, a gradual ramp-up in operations while normalising the working capital cycle remains crucial for BIL's cash flows in full year FY2021.

Rating sensitivities

Positive triggers – Given the Negative outlook, a rating upgrade in the near term appears less likely. However, ICRA could revise the outlook on BIL's ratings to Stable if it demonstrates a sustained and tangible improvement in working capital intensity, which results in an improvement in its liquidity profile, viz., higher cushion available in working capital limits. Besides, a sustained growth in scale of operations alongwith an improvement in profitability and a reduced dependence on debt, which results in improved debt servicing indicators, could be positive triggers. Specific credit metrics that could be considered for a rating upgrade include DSCR of more than 2.0 times, on a sustained basis.

Negative triggers – Negative pressure on BIL's rating could arise if there is a deterioration in its liquidity profile owing to, reasons including but not limited to, a further stretch in its working capital cycle. Besides, a prolonged impact of Covid-19 on demand and/or operating margins, which results in a higher than envisaged moderation in debt servicing indicators could also be a downgrade trigger. Specific credit metrics include DSCR of less than 1.5 times, on a sustained basis. Further, any sizeable debt-funded capex or investment undertaken by the company, which results in a deterioration in BIL's financial profile may also be downgrade triggers.

The company also faces prepayment risk given the possibility of debt acceleration upon the breach of rating linked covenants. Upon a failure to meet the covenant, if the company is not able to get waivers from the lenders/ investors or the lenders/ investors do not provide adequate time to the company to arrange for alternative funding to pay-off the accelerated loans, the ratings would face a downward pressure.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry - Apparels Liquidity Analysis of Entities in the Non-Financial Sector
Parent/Group Support	None
Consolidation/Standalone	For arriving at the rating, ICRA has considered the consolidated financials of BIL. As on March 31, 2019, the company had 10 subsidiaries, which are all enlisted in Annexure-2.

About the company

Initially incorporated as Bhartiya Galecha Industries Private Limited in January 1987, Bhartiya International Limited (renamed in July 1993) is a listed entity. It manufactures and exports leather garments and accessories (like wallets, hand bags, belts, etc). BIL is a recognised export house that derives its revenues mainly from the export of products to overseas markets like Spain, France, Austria, Italy, Switzerland, the US and Canada. The company's manufacturing facilities are located in Bangalore, Chennai and Nellore (Andhra Pradesh). It is backward integrated with its own tannery facilities in Chennai. As part of the forward integration initiatives, the company has also established its own design house in Italy, whose manufacturing is done in India. Besides leather products, the company also trades in textile apparels for which designing, raw material procurement and marketing activities are done in-house, while manufacturing is outsourced to manufacturers in China and Bangladesh.

Key financial indicators (audited)- Consolidated

	FY2018	FY2019	9M FY2020*
Operating Income (Rs. crore)	710.5	753.4	593.6
PAT (Rs. crore)	18.6	19.0	23.7
OPBDIT/OI (%)	7.1%	8.7%	9.2%
RoCE (%)	8.0%	8.4%	NA
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.3	NA
Total Debt/OPBDIT (times)	7.2	5.9	NA
Interest Coverage (times)	2.2	1.9	2.5
DSCR	1.7	1.5	NA

Source: BIL's Annual Reports, ICRA research
** Based on abridged financials reported by the company.*
NA= Not available

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the past three years:

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019	FY2018	
					26-May-2020	29-Nov-2019	31-Aug-2018	22-Dec-2017	13-Sep-2017
1	Fund-based facilities – Term Loans	Long Term	36.23	36.23^	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)
2	Non-fund-based facilities – Letter of Credit/ SBLC	Short Term	157.45	--	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A1	[ICRA]A1
3	Fund-based/Non-fund-based facilities	Long-term/ Short Term	360.00	--	[ICRA]BBB+ (Negative) / [ICRA]A2	[ICRA]BBB+ (Stable) / [ICRA]A2	[ICRA]BBB+ (Stable) / [ICRA]A2	[ICRA]A(Stable) / [ICRA]A1	[ICRA]A(Stable) / [ICRA]A1

Amount in Rs. crore
^Outstanding as on September 30, 2019

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Mar-2019	9.8%	FY2029	29.84	[ICRA]BBB+(Negative)
NA	Term Loan 2	May-2019	9.8%	FY2023	6.39	[ICRA]BBB+(Negative)
NA	Short-term non-fund-based limits	Apr-2019	--	NA	157.45	[ICRA]A2
NA	Short-term/long-term fund-based working capital limits	Apr-2019	--	NA	360.00	[ICRA]BBB+(Negative) /[ICRA]A2

Source: Bhartiya International Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Bhartiya Global Marketing Ltd.	100.00%	Full Consolidation
J&J Leather Enterprises Ltd.	88.95%	Limited Consolidation
Bhartiya International SEZ Ltd.	100.00%	Full Consolidation
Bhartiya Urban Infrastructure Ltd.	100.00%	Full Consolidation
Bhartiya Fashion Retail Ltd.	100.00%	Full Consolidation
Ultima S. A	100.00%	Full Consolidation
Design Industry Ltd.	100.00%	Full Consolidation
Design Industry China Ltd.	100.00%	Full Consolidation
Ultima Italia SRL	100.00%	Full Consolidation
World Fashion Trade Ltd.	100.00%	Full Consolidation

Source: BIL's Annual Reports; ICRA research

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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.

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