

November 11, 2020

Kitex Garments Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Working Capital Facilities	117.00	182.00	[ICRA]A1+; reaffirmed
Non-fund Based-Working Capital Facilities	20.00	26.50	[ICRA]A1+; reaffirmed
Unallocated facilities	39.71	34.52	[ICRA]AA-(Stable)/[ICRA]A1+; reaffirmed
Fund-based -Term Loans ¹	3.31	0.00	-
Total	180.02	243.02	

*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, hereafter collectively referred to as the Group), owing to the common management and strong operational linkages.

The ratings reaffirmation considers the Kitex Group's strong financial profile, characterised by a conservative capital structure with healthy coverage metrics and comfortable liquidity position, and the expected steady operational and financial performance of the Group in the coming quarters, supported by its established market position in the infantwear segment and strong relationship with large customers in the US market. While the operating performance was adversely impacted in March 2020 and the major portion of H1 FY2021 because of the pandemic with disruption in operations and deferment of orders, there has been a steady recovery in volumes in the recent months, which is expected to limit the overall decline in revenues and earnings in FY2021. ICRA expects the Kitex Group's revenue decline to be around 20% in FY2021, also constrained by the operational issues like the social distancing norms, limiting the capacity utilisation levels. A consistent growth in order inflows from existing large customers and addition of new customers are likely to drive volume growth of more than 10% per annum over the medium term, backed by its strong market presence in the infantwear segment. The Group's operating profitability is expected to remain healthy at around 20% despite a decline in revenues, supported by its integrated manufacturing set-up with a high level of automation and strong operating efficiencies and the cost reduction measures taken. This follows a period of strong volumes witnessed in FY2020, with the Group registering a revenue growth of around 12%. The operating margins were adversely impacted in FY2020, down by more than 500 bps, owing to the retrospective withdrawal of MEIS² and firm operating costs.

Despite reduction in earnings in the current fiscal, ICRA expects the Group's credit metrics to remain strong with minimal reliance on external debt. Key credit metrics including total debt to operating profits and operating profits to interest and finance charges are expected to be at around 0.5 and 10 times, respectively in FY2021. Also, the capital expenditure to be incurred in the near to medium term is likely to be lower than the earlier expected levels, given the challenging operating conditions witnessed. The company had proposed a large cumulative capital expenditure plan of Rs. 910 crore

¹ Term loans have been fully repaid; limits rated under term-loan facilities in the last exercise have been utilised towards the enhanced limits rated under the fund-based working capital facilities of the company

² MEIS - Merchandise Exports from India Scheme

(to be incurred during FY2019 to FY2025) towards 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. Out of the said capex plan, around Rs. 180 crore has been incurred till date (primarily towards land acquisitions) and the project is expected to be completed over an elongated timeframe given the deferment in expenditure witnessed. 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. 150 crore per annum from the next fiscal, 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. While the order book has recovered in the recent months, it remains sensitive to any future disruptions in business because of any pandemic-related demand pressure in key markets. 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, long relationship with key customers, aiding in repeat orders, ongoing measures towards new customer additions, strong operating efficiencies and healthy capitalisation levels.

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 infantwear 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. While the performance in the current fiscal is likely to moderate because of the pandemic, volumes are likely to witness a stable growth of ~10-12% per annum over the medium term. The expected shift in sourcing by large retailers from the competing supplier nations to India are likely to support the long-term growth potential of the Group.

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 comfortable liquidity position on the back of consistent earnings from operations generated over the years. Despite the large capital expenditure plan proposed, an expected steady growth in earnings is likely to limit dependence on external debt and support the credit profile of the Group. Key credit metrics including total debt to operating profits and operating profits to interest and finance charges stood at around 0.7 and 19 times, respectively in FY2020.

Credit challenges

Moderation in revenues and earnings witnessed in recent quarters; performance likely to improve going forward – While the Group's operating profits declined in FY2020 owing to the retrospective withdrawal of MEIS and an increase in operating costs, pandemic-related demand disruptions had an adverse impact during the major portion of H1 FY2021. Nevertheless, with the recovery in demand witnessed in the infant-wear segment coupled with the expected improvement in earnings in the second half of the current fiscal, the Group's operating profitability and credit metrics are likely to remain strong in the coming quarters.

High customer concentration and limited pricing power -- The top three customers of the Group continue to contribute the 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 addition to reduce dependence on its top three customers, with the new buyers likely to contribute around 15% to the revenues by the end of FY2022. Also, the Group has limited pricing power with established customers, which exposes its earnings to fluctuations in raw material prices and exchange rates. Firm raw material costs coupled with reduction in export incentives had constrained the Group's operating margins in FY2020.

Proposed large capacity expansion programme -- The Group had initiated a large expansion plan in FY2019 towards enhancement of capacities across the value chain. However, given the current challenging operating conditions, the Group has deferred the expenditure with the actual spend in FY2021 likely to be much lower than the earlier estimates. The expenditure is likely to increase only gradually from FY2022 when demand conditions stabilise. The project is in the nascent stage of development and the same exposes its 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 remains strong with cash balance of around Rs. 70 crore as on September 30, 2020), apart from enjoying large unutilised lines of credit. With the reduction in the scale of operations in the recent quarters, the average utilisation levels for the Group have reduced to around 20% in Q2 FY2021 (against ~45% in the 12 months ending September 2020). While the working capital funding requirements are expected to increase in the coming quarters with the growth in volumes, the liquidity position is expected to remain strong, supported by the likely growth in earnings (cash accruals of around Rs. 100 crore expected in FY2021), cash reserves held and large unutilised lines of credit.

Rating sensitivities

Positive triggers

The long-term rating may be upgraded if the scale of operations and earnings register a strong growth on a sustained basis to further enhance its competitive position, and the business profile becomes more diversified with new customer additions across geographies, while maintaining its strong credit metrics and liquidity position.

Negative triggers

Pressure on the ratings may arise if, for reasons including continued pressure on revenues and earnings because of the pandemic 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 pressure on the 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 15.9% stake in the company), manufactures and exports infantwear 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 capacity to manufacture more than 3 lakh pieces per day. The Kitex Group established a marketing and design unit based out of the US in FY2015 (equally held by KGL and KCL) to diversify its business profile and reduce dependence on its key customers.

Key financial indicators

Particulars (in Rs. Crore)	Kitex Group Consolidated	
	FY2019	FY2020
Operating Income (Rs. crore)	857.6	963.2
PAT (Rs. crore)	124.7	124.5
OPBDITA/OI (%)	27.6%	21.7%
RoCE (%)	26.4%	19.1%
Total Outside Liabilities / Tangible Net Worth (times)	0.4	0.4
Total Debt/OPBDITA (times)	0.7	0.7
Interest coverage (times)	31.5	19.2
DSCR	9.3	10.5

Note: KGL FY2020 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 (FY2021)			Chronology of Rating History for the Past 3 Years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Nov 11, 2020	Date & Rating in FY2020 Oct 04, 2019	Date & Rating in FY2019 Dec 31, 2018	Date & Rating in FY2018 Oct 06, 2017
1 Fund-based - working capital facilities	Short term	182.00	6.85	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2 Non-fund based working capital facilities	Short term	26.50	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Unallocated	LT/ST	34.52	-	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+
4 Term Loan	Long Term	0.00	-	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)

*Outstanding as on Sep 30, 2020; 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	Export packing credit and foreign bills discounting	-	-	-	182.00	[ICRA]A1+
NA	Letter of Credit & Bank Guarantee	-	-	-	26.50	[ICRA]A1+
NA	Unallocated	-	-	-	34.52	[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

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1120

jayanta@icraindia.com

Balaji M

+91 44 4596 4317

balaji.m@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

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

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

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