October 14, 2019

Paliwal Overseas Pvt. Ltd.: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facility (Term Loan)	36.07	30.29	[ICRA]A(Stable); reaffirmed
Long-term non-fund-based bank facility (Bank Guarantee)	13.17	13.17	[ICRA]A(Stable); reaffirmed
Long-term Unallocated	13.93	19.71	[ICRA]A(Stable); reaffirmed
Total	**63.17**	**63.17**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the rating, ICRA has consolidated the financials of various group entities of the Avinash Paliwal Group (referred to as the Paliwal Group or the Group, hereafter), namely Abhitex International (Abhitex), Paliwal Overseas Pvt. Ltd. (POPL) and Paliwal Infrastructure Pvt Ltd (PIPL), given the close ownership, financial and managerial linkages among them (refer to the ***Analytical Approach*** *for details).*

The rating continues to derive strength from the Group's favourable operational profile, with a diversified presence across textile and real estate businesses supported by the promoters' estensive experience in these segments, and a strong consolidated financial risk profile characterised by a conservative capital structure and healthy debt-coverage metrics. The promoters' experience of more than four decades in the textile industry and established relationships with reputed overseas clientele have facilitated repeat business, thereby supporting steady revenue growth in the Group's home textile segment over the years. Further, the segment benefits from favourable Government policies in the form of access to export incentives, which have supported steady profitability over the years. The Group's real estate operations, on the other hand, benefit from prime locations. Besides, competitive rentals of the leased properties in the past supported timely renewal of lease agreements by reputed tenants, resulting in high occupancy on a consistent basis.

Although the Group's return indicators (return on capital employed or ROCE of ~13% in FY2019) remain suppressed by large investments in certain non-return generating assets, ICRA expects its capitalisation and debt-coverage metrics to improve further (estimated total debt/operating profit before depreciation interest and taxes or TD/OPBDIT of less than 1.0 time in FY2020E) and remain robust in the near to medium term, with steady surplus cash accrual generation capacity of the businesses and a significant decline in the Group's term obligations from FY2021 onwards. Besides sizeable scheduled debt repayments during the current fiscal, the Group proposes to prepay additional debt through sale proceeds of a property in Delhi. Although reduced repayment obligations will also bolster the company's liquidity profile further, the extent of improvement will remain contingent upon the scale of any incremental investments in real estate assets or debt-funded expansion in the textile business, which the Group may undertake in line with its track record.

The rating, however, continues to be constrained by high client as well as geographical concentration risks in both textiles as well as lease rental businesses. Besides concentration of the Group's lease rental revenues on the top few clients, short to medium-tenure lease contracts with most of its clients exposes the Group to risks associated with timely renewal of leases at favourable rentals. Moreover, despite the decline in inventory days in the textile business in recent years, the inventory holding continues to be high, resulting in high working capital intensity. This also exposes the Group to risk of volatility in prices of raw material (mainly cotton yarn) and finished goods, as there is a lag between order booking and deliveries. In addition, profitability of the textile segment remains exposed to any adverse change in the export incentive structure, which currently supports the profitability of textile exporters, as well as intense competition from other domestic and international suppliers. Further, despite its presence across multiple products in the textile segment, the Group's dependence upon the terry segment remains high (~61% share in FY2019), which increases its vulnerability to demand-supply trends in this field.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that the Group will continue to benefit from the experience of its promoters in the home textiles and commercial real estate sectors, its established relationships with overseas clientele and the prime location of its commercial properties. This will help maintain stable revenue growth and a healthy financial risk profile. The revenue growth will be supported by capacity expansion of tufted products, scheduled rent escalations/ renewal of leases at higher rentals and leasing out of a vacant property in Delhi w.e.f November 2019.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in home textile and commercial real estate businesses – The Paliwal Group is promoted by Mr. Avinash Paliwal, who has extensive experience in the home textiles and real estate businesses. Operational since 1974, the textile arm of the Group, Abhitex, has more than four decades long track record in the sector. Further, the Group ventured into real estate in 2004 with the acquisition of a commercial property in Bengaluru, thus translating into more than a decade's experience in the commercial real estate market.

Strong relationships with overseas clientele including leading home furnishing retailers – Over the years, the Group has developed a strong client base in the export markets of the UK and USA, who have been providing repeat business. Abhitex derives almost its entire revenues from the export market with its client base comprising well established brands.

Prime location of the commercial properties in high demand business districts has facilitated consistently healthy occupancy by reputed clients – The leased-out properties of the Group are located in the secondary business districts (SBD) of Hyderabad and Bengaluru. The tenants include renowned companies from consulting and IT industries. Supported by the prime locations and their competitive rentals, the Group has been able to renew the leases in a timely manner, maintaining consistently healthy occupancy across both properties.

Strong financial profile – The Group has a strong financial profile, characterised by a strong capital base (net worth of Rs. 428 crore as on March 31, 2019), a conservative capital structure (gearing of 0.3 time and TOL/ TNW of 0.5 time as on March 31, 2019) and healthy debt-coverage indicators (interest coverage of 13.1 times and Total Debt/ OPBDITA of 1.7 times in FY2019). With progressive debt repayments and limited debt-funded capital investments, there has been a consistent decline in the Group's term borrowings in the past few years. Further availability of surplus cash accruals for part funding of working capital requirements, has kept reliance on working capital borrowings range-bound despite increasing scale of operations. This together with healthy profitability has facilitated an improvement in the Group's capitalisation and debt coverage metrics in recent years. Further, supported by the expected surplus accrual generation from operations and proposed sale proceeds from a property in Delhi, the Group is likely to prepay additional debt (beyond the scheduled debt repayments) during the current fiscal, thereby completely retiring its term obligations. This is expected to strengthen its capitalisation and coverage metrics and boost its liquidity position. Nevertheless, the extent of improvement will remain contingent upon scale of any incremental investments in real estate assets or debt-funded expansion in the textile business, which the Group may undertake in line with its track record.

Credit challenges

High export dependence with geographic concentration makes the Group's textile business vulnerable to slowdown in the export markets – Abhitex derives almost its entire revenue (~99%) from the export market, mainly driven by US market (with a ~57% share in its total revenues in FY2019), followed by the UK (~34%). High reliance on exports with concentrated exposure to these two markets exposes Abhitex's and the Group's revenue as well as profitability to any slowdown in these markets. ICRA, however, notes that the forex fluctuation risk remains abated by Group's prudent policy of hedging the forex exposure.

High working capital intensity owing to high inventory holding in the textile business – Although Abhitex' inventory holding has reduced over the years from 181 days in FY2015 to 113 days in FY2019, it continues to be high, thereby exposing the profitability to volatility in raw material prices (primarily cotton yarn). The large inventory holding period, in-turn, emanates from the requirement of large finished goods inventories for export orders besides raw material stock. As a result, reliance on working capital borrowings in the textile segment remains high, with fund-based working capital limit utilisation averaging at over 70% (over 85% against drawing power) in the 12-month period ended April 2019.

High reliance on export incentives provided by the Government – The profitability of Abhitex, like other textile exporters, is supported by export incentives, provided by the Government of India, which account for ~70% of the operating profits of Abhitex. Besides, these incentives have also been supporting growth in sales by making domestic textile manufacturers competitive in the global market. This exposes the exporters' profitability to any adverse changes in the policies.

High customer concentration in lease rental properties and short-tenure of lease contracts – The lease rental business of the Group has a high customer concentration as reflected by the top tenant occupying around 90% and 67% of the area in the Hyderabad and Bengaluru properties, respectively. Besides concentration of the Group's lease rental revenues on the top few clients, short-tenure of lease contracts (2-5 years for 81% of area) with most of its clients exposes the Group to risks associated with timely renewal of leases at favourable rentals.

Track record of aggressively deploying surplus accruals in non-return generating real estate investments of the Group –The Paliwal Group has been deploying surpluses in non-return generating real estate assets, which constrain the return indicators. The major investments have been made in residential real estate projects in Panipat (Haryana). Given that most of these investments are not generating any returns, they have supressed the Group's return indicators (as reflected in a consolidated ROCE of ~13% in FY2019). Although work has not begun on these projects yet, the Group proposes to undertake a phased development, going forward. The scale of development is, however, expected to remain small, which is not likely to alter the Group's credit risk profile materially. Any major incremental investments towards these projects that affect the Group's liquidity position and/or results in increased leveraging would remain a rating sensitivity.

Liquidity position: Strong

The Group's liquidity is **strong** with healthy retained cash flow generation in the range of Rs. 50-60 crore per annum, limited firm capex plans and comfortable working capital limit utilisation (averaging ~88% over the 12-month period ended April 2019). As on March 31, 2019, the Group had free cash and bank balances of Rs. 7.2 crore. With limited term debt obligations outstanding and proposal to use proceeds from sale of a property to prepay the remaining debt, the Group is likely to generate comfortable free cash flows from FY2021 onwards and maintain a strong liquidity position. Although the Group's financial flexibility is also expected to improve because of access to unencumbered rental income (with debt against the existing properties getting repaid), any aggressive/ sizeable acquisitions by the Group or deployment of funds in non-return generating assets without commensurate funding tie ups, could impact its liquidity position.

Rating sensitivities

Positive Triggers: The rating could be upgraded if the Group achieves a sustained healthy growth in its scale of operations, while maintaining consolidated ROCE at over 17%, and reports better than expected cash accruals, which together with debt reduction translates into improvement in debt metrics, such that consolidated Debt/ OPBDITA remains below 1.2 times on a sustained basis.

Negative Triggers: The rating could be downgraded if the Group undertakes aggressive debt-funded investments/ acquisitions or deploys funds in non-return generating investments, resulting in deterioration in leverage (such that Consolidated Debt/ OPBDITA increases to more than 2.0 times) and/ or coverage metrics (such that OPBDITA/ Interest falls below 5.0 times) on a sustained basis. Any substantial decline in the occupancy level in the real estate business on a sustained basis, affecting revenue visibility and profitability and/ or any adverse revision in export incentives that exerts pressure on profitability and return indicators, will also be a negative rating trigger. Additionally, any stretch in the working capital cycle, affecting the group's liquidity profile, could exert a downward pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Indian Textiles Industry – Fabric Making Rating Methodology for Debt Backed by Lease Rentals Consolidation and Rating Approach
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the rating, ICRA has consolidated the financials of various Group entities (as mentioned in Annexure-2) given the close ownership, financial and managerial linkages among them.

About the company

Paliwal Overseas Pvt. Ltd. (POPL) was incorporated in 1985 by Mr. Avinash Paliwal to undertake operations in the textile sector. POPL purchased a commercial property in Bengaluru in 2004 and has since been engaged in the business of leasing commercial office space. The building has 100% occupancy at present with leases to reputed companies. The company deploys surplus funds from the business towards other real estate ventures of the Avinash Paliwal Group.

In FY2019, the company reported a net profit of Rs. 15.0 crore on an operating income of Rs. 28.5 crore compared to a net profit of Rs. 19.0 crore on an operating income of Rs. 26.7 crore in the previous year.

About the Group:

PIPL is a part of the Avinash Paliwal Group of Panipat, which has business interests in home textiles and real estate sectors. The Group is promoted by Mr. Avinash Paliwal, who has more than four decade's long experience in manufacturing and exporting textile products. The key operations of the Group are carried out by three entities—namely, Abhitex, POPL and PIPL. While Abhitex operates in the home textiles space, POPL and PIPL own leased commercial buildings.

In FY2019, at a consolidated level, the Group reported a net profit of Rs. 46.9 crore on an operating income of Rs. 373.9 crore compared to a net profit of Rs. 49.0 crore on an operating income of Rs. 346.5 crore in the previous year.

Key financial indicators- (audited)

	Standalone FY2018	FY2019	Consolidated^ FY2018	FY2019
Operating Income (Rs. crore)	26.7	28.5	346.5	373.9
PAT (Rs. crore)	19.0	15.0	49.0	46.9
OPBDIT/OI (%)	81.5%	79.1%	22.9%	21.8%
RoCE (%)	12.2%	8.4%	14.6%	13.0%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.3	0.6	0.5
Total Debt/OPBDIT (times)	1.3	1.9	1.7	1.7
Interest Coverage (times)	33.0	655.1	8.7	13.1
DSCR	1.7	2.0	1.8	1.7

^ Consolidated financial estimates for Abhitex, POPL and PIPL

Source: Financial statements of entities, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					14-Oct-2019	30-Jul-2018	21-Jun-2017	21-Jul-2016
1	Term Loan	Long Term	30.29	30.29	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)
2	Bank Guarantee	Long Term	13.17	NA	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)
3	Unallocated Limits	Long Term	19.71	NA	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	-

Amount in Rs. crore

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	FY2015	NA	FY2022	9.25	[ICRA]A (Stable)
NA	Term Loan	FY2018	NA	FY2023	10.74	[ICRA]A (Stable)
NA	Term Loan	FY2019	NA	FY2022	10.30	[ICRA]A (Stable)
NA	Bank Guarantee	NA	NA	NA	13.17	[ICRA]A (Stable)
NA	Unallocated limits	NA	NA	NA	19.71	[ICRA]A (Stable)

Source: POPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Abhitex	100% owned by promoters and Group entities	Full Consolidation
POPL	100% owned by promoters	Full Consolidation
PIPL	100% owned by promoters and Group entities	Full Consolidation

Analyst Contacts

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

Nidhi Marwaha
+91 124 4545 337
nidhim@icraindia.com

Pratika Bhandari
+91 124 4545 321
pratika.bhandari@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
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