Kitex Garments Limited

December 31, 2018

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loans	8.94	5.34	[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	34.08	37.68	[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 considered the 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 rating re-affirmation reflects the expected strong performance of the Kitex Group in FY2019 on the back of robust growth in order book position witnessed in recent quarters. The Group is expected to record revenue growth of over 20% in the current fiscal, as reflected in its steady H1 FY2019 performance and strong order book position at the end of Q2 FY2019, driven by a combination of healthy growth in volumes and moderate improvement in realisations. This improvement follows the modest performance witnessed in the last two fiscals, when revenue growth and earnings were under pressure during a major part of the period. The same was owing to loss of business from few customers, slowdown in order inflow from other key customers and lack of new customer additions. Besides a modest revenue growth in FY2018, the operating margins fell sharply due to reduction in export incentives post implementation of the Goods and Services Tax (GST) coupled with rising operating costs. Nevertheless, the Group's operating margins have recovered during H1 FY2019, backed by better economies of scale and improved contribution levels. Operating margins over the medium term are expected to remain at around 25-27%, driven by its integrated manufacturing setup with a high level of automation and strong operating efficiencies. Further, addition of new customers and consistent growth in order inflow from existing large customers are likely to drive steady revenue growth of 15-20% over the medium term, backed by its established presence in the infant wear export market. The ratings also factor in the continued high customer concentration and limited pricing power, exposing earnings to the risks of fluctuations in raw material prices and exchange rates, which had impacted earnings to an extent during the recent fiscals. The recent addition of new customers is expected to reduce dependence on the existing large players to around 80% by the end of FY2020.

The rating continues to derive comfort from the Group's strong financial profile, characterised by a conservative capital structure and comfortable liquidity position (the Group remained net debt negative as on September 30, 2018). ICRA notes the proposed cumulative capital expenditure plan of Rs. 910 crore for the period FY2019 to FY2025 towards significant addition of capacities across the value chain including knitting, processing and garmenting. Despite the large size of the envisaged expansion, the Group's dependence on external debt is likely to be limited because of the expected strong growth in earnings driven by the recent addition of large customers. The Group's cash accruals are expected to remain more than Rs. 150 crore per annum during the same period, which would result in Total Debt to Tangible Net Worth (TD/TNW) and Total Debt to operating profits (TD/OPBDITA) not exceeding 0.4 times and 1.0 times, respectively.

As the Group's ability to sustain growth in revenues and earnings is critical to support its capital structure and liquidity position, ICRA would continue to monitor the same and it would remain a key rating sensitivity.

Outlook: Stable

ICRA believes that the Kitex Group will continue to benefit from its established presence, growing customer base and ongoing capacity additions as witnessed in the growth recorded during recent quarters. The outlook may be revised to Positive if revenues and earnings significantly exceed estimates and strengthen the financial risk profile. The outlook may be revised to Negative if the earnings are weaker than expected and consequently result in higher dependence on debt to fund the proposed expenditure program, which would result in deterioration in capital structure and coverage indicators.

Key rating drivers

Credit strengths

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

- **Healthy orderbook position**: Post the modest performance in recent fiscals, the Group's performance improved in H1 FY2019, driven primarily by growth in volumes. With the order book position remaining at healthy levels at the end of September 2018 coupled with recent addition of new customers, volumes are likely to witness a robust growth of 15-20% 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 is 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 value-added segment (printing and embroidery), coupled with strong operational infrastructure to meet stringent quality requirements, with high levels of automation results in better-than-average industry margins for the Group.

- **Healthy financial profile:** The Kitex Group enjoys strong financial flexibility, backed by its conservative capital structure with adequate coverage metrics and healthy cash reserves held on the back of consistent earnings generated over the years. Despite the large capital expenditure plan proposed for the period FY2019 to FY2025, 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 to more than 90% of volumes, which exposes revenues to the performance of its key customers as seen during the recent fiscals. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, reflected in the repeat business generated over the years. Further, the Group's ability to sustain revenues and earnings to an extent through its focused efforts towards customer additions, as seen in H1 FY2019, provides comfort.

- **Limited pricing power**: The company has limited pricing power with established customers, which exposes earnings to fluctuations in raw material prices and exchange rates. Pressure on average product realisations against firm operating costs, coupled with drop in export incentives constrained the Group's operating margins, which fell to around 21% in FY2018. Nevertheless, an increase in product prices coupled with better economies of scale and improved contribution levels has supported recovery in margins in H1 FY2019 and is expected to sustain over the medium term.

- **Proposed large capacity expansion programme**: As mentioned earlier, the Group has a sizeable expansion plan with capital expenditure of Rs. 910 crore proposed over the next six years, with the project in the nascent stages of development. The same exposes earnings to execution related risks as any major time or cost overrun could 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 capacity expansion to be undertaken only in stages also buffers the risk to an extent.

Liquidity Position:

The liquidity position of the Kitex Group has remained strong (with cash balance of Rs. 159 crore as on September 30, 2018), despite pressure on revenue growth and earnings witnessed in FY2018, supported by limited funding requirements. While the planned capital expenditure could reduce the quantum of free cash flows generated, steady growth in earnings from operations, limited dependence on external debt, cash reserves held and adequate unutilised lines of credit are likely to support the liquidity position of the company.

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 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 15.47% 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 2.7 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).