

June 30, 2023

Kitex Garments Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short term - Fund-based Limits – Working Capital Facilities	182.00	185.00	[ICRA]A1 reaffirmed
Short term - Non-Fund based Limits – Working Capital Facilities	20.00	20.00	[ICRA]A1 reaffirmed
Long term/Short term - Unallocated	23.02	20.02	[ICRA]A+ (Negative)/ [ICRA]A1 reaffirmed; outlook revised to Negative from Stable
Short term - Non-Fund based Limits – Credit Exposure Limits	18.00	18.00	[ICRA]A1 reaffirmed
Total	243.02	243.02	

*Instrument details are provided in Annexure-I

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 linkages between the entities.

The change in the outlook factors in the moderation in the Group's overall operating and financial performances in FY2023 due to subdued demand from key export markets following a recession in the US and EU. In addition, ICRA expects the demand outlook to remain weak at least till Q2 FY2024. The ratings, however, remain supported by the established market position of the Group in the infantwear segment and strong relationship with large customers in the US market. The ratings get further support from the company's strong operating efficiencies, backed by high level of automation and an integrated manufacturing setup, and an expected improvement in business diversification upon commissioning of the proposed capacities. The Group is in the process of setting up integrated textile units in Telangana across two phases under Kitex Apparel Parks Limited (KAPL), at a total cost of around Rs. 2,890 crore, including preoperative expenses, to be funded largely by term loans from banks (70% of the project cost). The first phase is likely to be completed by March 2024 and the second phase by March 2025. There has been no cost overrun as of May 2023. The large expansion exposes its earnings to execution and demand risks, with the new capacities estimated to be more than double the existing level of operations. Nevertheless, rich experience of the promoters, its strong market position, long relationships with customers and favourable demand conditions in the long run, given the increasing shift in procurement of large customers in the US and EU markets from China towards other markets including India, provide some comfort. Market players, including the Kitex Group, are expected to benefit from this shift, especially in the infant wear market as China caters to the major part of the requirements and India also holds an edge over other competing nations in this segment. Further, over the medium-to-long term, expanded capacities would enable diversification benefits with the company planning to venture into new value-added product segments and cater to a wider customer base across geographies.

The ratings, however, remain constrained by the expected moderation in the Group's financial performance (amid a slowdown in end demand across EU and the US), and stretching of the credit metrics over the medium term owing to the proposed large debt-funded capacity expansion amid a weak operating environment. ICRA expects that the Group's metrics including gearing and total debt to operating profits are likely to increase to the peak levels of around 1.3 times and 6.8 times, respectively, by FY2025, and further improve in the subsequent fiscals as the capacities start generating earnings. Nevertheless, cash flows and coverage metrics are expected to remain at adequate levels over the next fiscal, with the minimum debt service coverage ratio

(DSCR) expected to be at around 3.7 times. The earnings and liquidity position would be supported by the sizeable subsidies to be enjoyed from the state (although timely receipt of the same remains to be seen) and the healthy margins expected from the new products as well (given the strong value addition and integrated manufacturing setup). The ratings continue to factor in the project execution and implementation risks, customer acquisition risk for the new project, existing high customer and geographical concentration risks, high working capital requirements in the business, exposure of the Group's performance 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 Negative outlook reflects ICRA's expectation of sustained demand-side pressure in the global apparel market till Q2 FY2024, which might put pressure on the company's operational and financial performances as well.

Key rating drivers and their description

Credit strengths

Established market position in the infant wear export segment – The Kitex Group is among the largest manufacturers and exporters of infant wear from India, with a demonstrated track record of more than two decades. The Group operates in the niche segment of manufacturing garments for infants, where stringent quality requirements and relationships with customers pose as entry barriers. The promoter's extensive experience in the apparel industry and established relationships with leading international brands supported revenues and earnings over the years. The expected shift in sourcing by large retailers from the competing supplier nations to India, and the proposed diversification to new products and customers are likely to support the long-term growth potential of the Group.

Integrated manufacturing facility – The Group 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), healthy level of automation and strong operational infrastructure to meet stringent quality requirements resulted in better-than-average industry margins for the Group. The proposed addition of spinning facilities and widening of capacities across other sections of the value chain are expected to further improve the overall value addition.

Proposed expansion to improve business diversification – The Group is in the process of diversifying its business profile, with the ongoing capacity expansion expected to improve its product, customer and geographical diversification over the medium-to-long term. Further, the additional capacity would aid the Group in reducing the concentration risks with specific set of customers and the US market, with plans to widen its client portfolio to include other major retailers in the US and EU markets.

Credit challenges

Moderation in financial performance, however, debt coverage metrics remain comfortable over the medium term – There has been a moderation in the Group's overall operating and financial performance in FY2023 due to subdued demand from key export markets following a recession in the US and EU. The consolidated operating income declined ~23% to Rs. 893.7 crore in FY2023. This together with higher raw material prices during the year has also resulted in a moderation in its operating margin to 14.7% in FY2023 from 22.9% in FY2022. Further, ICRA expects the demand outlook to remain weak at least till Q2 FY2024. ICRA expects the company to report a 24% growth in its revenue, while the interest coverage ratio is expected to tighten to ~8-9 times as the company draws down the debt for the new project. The demand situation is expected to improve thereafter. Despite the performance pressure, the Group's liquidity position and debt protection metrics are expected to remain adequate in the medium term.

Exposure to project and market risks owing to large proposed debt-funded greenfield capacity – KAPL has initiated a large textile greenfield capacity worth Rs. 2,890 crore in Telangana, to be completed by March 2025, for creation of capacities across the value chain. As the expansion would be largely funded through debt (70% by term loans and the remaining to be infused in the form of equity by the parent), the financial profile would remain modest till the project is completed and the capacity starts generating adequate earnings. Further, the project is in the nascent stage of development, which exposes its earnings to execution related time and cost overrun risks inherent to large projects. The company has incurred ~Rs. 633 crore till June

15, 2023 and there has been no cost overrun so far. There has been a slight increase in the project cost compared to the initially envisaged project cost of Rs. 2,600 crore. However, this was due to non-inclusion of interest during construction (IDC) charges initially and no further cost overrun is expected. The project would also be exposed to market risks upon commissioning, considering the large capacity being added. However, the Group's established presence is likely to support KAPL in securing timely orders.

High customer and geographical concentration risks – The Group's revenues remain susceptible to business concentration risk, till the new capacities are commissioned and the Group diversifies its customer base, as more than 90% of its revenues is generated from the US market and a large portion of its sales is generated from its top-3 customers. ICRA notes the customer acquisition risk for the new facilities, given the capacity is set to more than double the existing amount. However, the risk is mitigated to an extent by the established relationship enjoyed with its clientele.

Limited pricing flexibility exposes earnings to price risk – The Group's earnings remain exposed to fluctuations in raw material prices and exchange rates on the back of limited pricing flexibility enjoyed with key customers. The Group faces competition from other large textile exporters from India as well as from other low-cost garment exporting countries, which limits its ability to improve prices and margins to an extent. While order-backed procurement limits price risk because of movement in yarn prices, its earnings have been protected to a large extent against fluctuations in exchange rates through the hedging arrangement undertaken.

Liquidity position: Adequate

The Group's liquidity position is likely to remain adequate despite the large ongoing capital expenditure. The same would be supported by the expected steady cash accruals in the coming years, cash buffer held and project debt to be availed for part funding the capital expenditure, given the strong financial flexibility enjoyed with the banks. There is no scheduled debt repayment for the next 12 months. The Group had free cash reserves of ~Rs. 33.2 crore as on April 30, 2023, apart from large unutilised lines of credit. Further, it is required to maintain one quarter's principal and interest amount due in the Debt Service Reserve Account (DSRA) under KAPL. DSRA is required to be opened before one quarter of commencement of scheduled repayments of term loan (i.e. towards the end of FY2026).

Rating sensitivities

Positive factors – An upgrade in the ratings in the near term is unlikely. The outlook can be revised to Stable if the entity is able to sustain its revenue growth and margin expansion in the medium term, leading to an improvement in its return and debt protection metrics.

Negative factors – The ratings may be downgraded in case of any sustained pressure on the Group's operating performance, or any sharp elongation in its working capital cycle. Further, any material time or cost overrun in the new project could result in ratings downgrade. Specific credit metrics that may lead to a rating downgrade include DSCR reducing to less than 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Indian Textiles Industry – Apparels Rating approach - Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the business and financial risk profiles of Kitex Garments Limited and Kitex Childrenswear Limited (collectively referred to as the Kitex Group), owing to the common management and strong linkages. It should be noted that Kitex Apparel Park Limited is consolidated under Kitex Garments Limited.

About the company

Kitex Garments Limited (KGL) was incorporated in 1992 and is managed by Mr. Sabu Jacob. The company is a part of the larger AnnaKitex Group, which has diversified interests across various sectors. KGL, along with its Group company, KCL (which holds a 15.9% stake in KGL), manufactures and exports infantwear to apparel retailers based out of the US and other developed markets. The Group has a fully integrated manufacturing facility at Kizhakkambalam (Kerala) with a capacity to manufacture around 235 million pieces per annum. 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. The Group is in the process of setting up two new large integrated manufacturing units in Telangana across two phases in Warangal and Sitarampur, which are expected to fully commercialise by March 2024 and March 2025, respectively.

Key financial indicators

Consolidated	FY2021	FY2022	FY2023
	Audited	Audited	Provisional
Operating income	703.1	1,162.8	893.7
PAT	83.0	167.6	74.9
OPBDIT/OI	22.5%	22.9%	14.7%
PAT/OI	11.8%	14.4%	8.4%
Total outside liabilities/Tangible net worth (times)	0.2	0.3	0.4
Total debt/OPBDIT (times)	0.1	0.3	0.3
Interest coverage (times)	31.6	44.1	23.0

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years					
		Amount rated (Rs. crore)	Amount outstanding as of Apr 30 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022			Date & rating in FY2021
				Jun 30, 2023	Mar 31, 2023	Mar 04, 2022	Oct 01, 2021	Jul 20, 2021	Nov 11, 2020
1 Fund-based Limits – Working Capital Facilities	Short Term	185.00	--	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+
2 Non-Fund based Limits – Working Capital Facilities	Short Term	20.00	--	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+
3 Unallocated	Long Term / Short Term	20.02	--	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]AA-@/ [ICRA]A1+@	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
4 Non-Fund based Limits – Credit Exposure Limits	Short Term	18.00	--	[ICRA]A1	[ICRA]A1	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based - working capital facilities	Very Simple
Non-fund based working capital facilities	Very Simple
Unallocated limits	Not Applicable
Non-fund based Credit Exposure Limits	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based Limits – Working Capital Facilities	NA	NA	NA	185.00	[ICRA]A1
NA	Non-Fund based Limits – Working Capital Facilities	NA	NA	NA	20.00	[ICRA]A1
NA	Unallocated	NA	NA	NA	20.02	[ICRA]A+ (Negative)/ [ICRA]A1
NA	Non-Fund based Limits – Credit Exposure Limits	NA	NA	NA	18.00	[ICRA]A1

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Kitex Herbals Limited	100%	Full Consolidation
Kitex Infantwear Limited	100%	Full Consolidation
Kitex Apparels Limited	100%	Full Consolidation
Kitex USA LLC (note 1)	50%	Equity method
Kitex Apparel Parks Limited	30%	Full Consolidation
Kitex Childrenswear Limited	15.9%	Full Consolidation
Kitex Littlewear Limited (note 2)	-	Full Consolidation
Kitex Babywear Limited (note 2)	-	Full Consolidation
Kitex Socks Limited (note 2)	-	Full Consolidation
Kitex Packs Limited (note 2)	-	Full Consolidation
Kitex Knits Limited (note 2)	-	Full Consolidation
Kitex Kidswear Limited (note 2)	-	Full Consolidation

Source: Company

Note 1 - Kitex USA LLC is a 50:50 joint venture between KGL and KCL

Note 2 – These entities are subsidiaries of KGL

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