KG Petrochem Limited

September 25, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long term Bank Facilities	91.80	CARE BBB; Stable (Triple B; Outlook: Stable)	Assigned
Short term Bank Facilities	32.20	CARE A3+ (A Three Plus)	Assigned
Long term/Short term Bank Facilities	58.00	CARE BBB; Stable/CARE A3+ (Triple B; Outlook: Stable/ A Three Plus)	Assigned
Total Facilities	182.00 (Rupees One hundred eighty two crore only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KG Petrochem Limited (KGPL) derive strength from the vast experience of the promoters in terry towel segment of textile industry along with established track record of operations and repeat orders from its reputed clientele. The ratings further derive strength from its growing scale of operations backed by diversification of revenue streams along with healthy profitability margins, moderate debt coverage indicators and adequate liquidity despite elongated operating cycle.

The ratings, however, remain constrained on account of its leveraged capital structure and foreign exchange fluctuation risk associated with export receivables. The ratings are further constrained on account of non-stabilisation of operations of its recently completed diversification project in artificial leather business, project implementation risk associated with ongoing projects, customer as well as geographical concentration of revenue, inherent cyclicality associated with textile industry and vulnerability of profitability to the fluctuation in raw material prices.

KGPL's ability to increase its scale of operations along with stabilisation of operations of artificial leather unit and timely completion of ongoing projects without any cost overrun and stabilisation of operations thereon leading to envisaged returns from completed projects and improvement in its profitability margins and capital structure along with shortening of its collection period would be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters: KGPL is promoted by Mr G. S. Kandoi, a Mechanical Engineer from BITS Pilani having vast experience of more than five decades. He is ably supported by Mr Manish Singhal, an IIT graduate and son of Mr G. S. Kandoi who has total experience of around 15 years. The Board of Directors consists of three independent directors and two whole time director as well as multidisciplinary professionals at various levels. However, the decision making is concentrated within promoter group.

Established operations with long track record: KGPL has an established track record of 38 years. KGPL operates in two segments, i.e. manufacturing of terry towels & made-ups and consignment stockiest of GAIL (India) Limited for polymers for Rajasthan region. Further, the company has also started manufacturing of artificial leather in FY19.

Growing scale of operations with healthy profitability margins: Total Operating Income of KGPL has increased at Compounded Annual Growth rate (CAGR) of 5.28% over last three financial years ending FY19 backed by increasing trend of average sales realisation on terry towels and commencement of operation of artificial leather unit in July, 2018.

PBILDT margins have inherently remained healthy due to higher value addition and export incentives (duty draw back, duty credit scripts, Rebate on State Levies (ROSL) scheme) received from Government of India. The company has in-house weaving, printing, designing and embroidery facilities. PBILDT margin of KGPL increased by 212 bps to 15.19% in FY19 on account of higher average sales realisation on terry towels. However, PAT margin remained stable at 3.38% in FY19, despite improvement in PBILDT margin, on account of higher provision for deferred tax liability. The gross cash accruals of the company also exhibited an increase from Rs.20.24 crore in FY18 to Rs.27.76 crore in FY19.

During Q1FY20, KGPL reported TOI of Rs.90.65 crore with PBILDT and PAT of Rs.14.32 crore and Rs.5.50 crore respectively translating to PBILDT and PAT margin of 15.80% and 6.07% respectively as against TOI of Rs.43.31 crore with PBILDT and PAT of Rs.5.88 crore and Rs.1.30 crore respectively in Q1FY19 translating to PBILDT and PAT margin of 13.58% and 3% respectively.

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Moderate debt coverage indicators: The debt coverage indicators of KGPL stood moderate with total debt to GCA of 5.04 times as on March 31, 2019 as against 6.48 times as on March 31, 2018 on account of increase in cash accruals. PBILDT interest coverage moderated to 5.75 times during FY19 as against 5.86 times during FY18 due to increase in interest cost following increase in debt availed for funding capex.

Key Rating Weaknesses

Geographical as well customer concentration risk: The company generated around 77% of TOI from exports with around 59% of TOI from sales to USA based customers and 10% of TOI to Chile based customers in FY19. Further, revenue of the company is concentrated with sales to its top two customers, viz. Walmart Inc. and Saturday Knight Limited comprising around 33% to its TOI of FY19, though the clients are reputed. Any change in customer preference and/or political instability and economic slowdown in these markets will impact the operations of KGPL. However, KGPL has long established relationship with these clients which have resulted in repeat business from them over a long period of time.

Inherent cyclicality associated with the textile industry, impact of government regulations and climatic condition: Prices of raw cotton are volatile in nature and depend upon factors like area under production, yield for the year, international demand supply scenario, export quota decided by the government and inventory carry forward from the previous year. Again, production of cotton in India is also highly dependent upon the vagaries of the monsoon. The volatility exhibited in the price of cotton during last 36 months is largely attributed to the varied stance taken by the government on the export of cotton and cotton yarn along with decline in export demand mainly from China. Textile is a cyclical industry and closely follows the macroeconomic business cycles. High competitive intensity in the textile industry, volatility of cotton and crude oil prices, rising inflation levels are the major cause of concern for the Indian textile industry.

Leveraged capital structure: The capital structure of KGPL remained leveraged with overall gearing of 2.06 times as on March 31, 2019 despite improvement from 2.22 times as on March 31, 2018 on account of accretion of profit to reserves.

Stabilization risk associated with completed project as well as implementation risk associated with ongoing projects

KGPL completed first phase of diversification project involving manufacturing of artificial leather in July 2018. Although, the company has generated revenue of Rs.19.06 crore in FY19 and Rs.10.76 crore in Q1FY20 from the said project (phase-I), operations of said division are yet to be stabilized and are yet to turn profitable. While the company is generating healthy margins from terry towel division, stabilisation of operations of the artificial leather unit is crucial.

Further, second phase of the project, which involves installation of additional production line for manufacturing of artificial leather, is at advanced stage of completion. The company has incurred Rs.8.44 crore towards the project funded through term loan of Rs.6.26 crore and remaining through internal accruals till July 31, 2019 as against envisaged cost of Rs.18.67 crore to be funded through term loan of Rs.14 crore and remaining through internal accruals. Further, the company proposes to incur cost of Rs.2.87 crore (apart from Rs.18.67 crore) for additional machinery for the second phase which will be funded through term loan of Rs.2.14 crore and remaining through internal funds. The project is expected to be completed by October, 2019.

The company has almost completed installation of printing machine (terry towel division) and incurred total cost of Rs.5.95 crore till July 31, 2019 funded through term loan of Rs.4.21 crore and remaining through internal accruals against revised envisaged total cost of Rs.8.33 crore to be funded through term loan of Rs.6.25 crore and remaining through internal accruals. The company is expected to commence commercial operations of the printing machine by October, 2019.

Further, the company has commenced execution of project involving backward integration through installation of weaving plant for manufacturing of fabric for artificial leather with total cost of Rs.13 crore to be funded through term loan of Rs.9.75 crore and remaining through internal accruals. The company is yet to achieve financial closure for the said project. The project is expected to be completed by March 2020. Timely completion of ongoing projects without any cost overrun while achieving financial closure for the backward integration project and stabilization of operations thereon while earning envisaged returns would be key rating sensitivity.

Foreign exchange rate fluctuation risk; albeit partly mitigated through prudent hedging mechanism though raw material prices fluctuation risk persists: The export sales constituted around 77% of TOI of KGPL in FY19. KGPL hedges its 90-100% of foreign exchange exposure arising from export of products through forward contracts which mitigates the exchange rate fluctuation risk to a large extent. Further, the company avails a part of its fund-based limit in the form of Pre-shipment credit in foreign currency (PCFC) for pre-shipment / post shipment advance to hedge against foreign exchange rate fluctuation. During FY19, the company earned foreign exchange gain of Rs.4.07 crore as against foreign exchange gain Rs.3.66 crore in FY18.

Further, price of its key raw material i.e. cotton yarn which constituted around 93% of total material cost consumed in FY19, has been increasing continuously for last three financial years ending FY19. Further, PVC resin powder, fabric, release paper and various chemical are the key raw material for artificial leather manufacturing unit. Majority of these raw materials are derivative of crude oil exposing KGPL to the volatility in fluctuation of crude oil prices. The company's profitability margins remained exposed to any sharp movement in its key raw material prices.

Industry Outlook

India remained amongst the largest exporter of garments in the world. The export of readymade garment witnessed a negative growth rate of around 3.8% during FY18 due to decrease in competitiveness of Indian players after implementation of GST. India's garment exports also reduced primarily due to competition from countries like Bangladesh, Sri Lanka etc. which have low production cost and enjoy preferential duty access in key markets. Exports further declined by 5.2% in 11MFY19 on account of depressed economic condition. United States (US) and the European Union (EU) continued to be largest exporting destination for India accounting 60% of the apparel exports from the country in FY18. CARE estimates Indian apparel exports to remain subdued, growing marginally in rupee terms, and declining in US dollar terms. India continues to experience headwinds in the form of intense competitive pressures from nations having a cost advantage over India, which seem to be constraining the overall momentum of the apparel export sector of India. With the industry now stabilizing post the demonetization and the implementation of the goods and service tax (GST) regime, the demand from downstream industry - apparels and made-ups from both domestic and international markets, has only marginally picked up in the last few months.

CARE expects the domestic apparel market to grow by 10% - 12% driven by the growth in the Indian economy leading to the rise in disposable income, increased usage of plastic money leading to impulsive buying among the Indian consumers. Also, the increasing percentage of the youth in the Indian economy, rising mall culture would continue to drive growth of the apparel industry. Plethora of international and home-grown premium and super premium brands has led to a sharp increase in the per unit realisation which is expected to drive the market size of the Indian apparel industry.

The Government of India has taken several measures including Amended Technology Upgradation Fund Scheme (A-TUFS) to enable investments worth Rs 95,000 crore (US$ 14.2 billion) by 2022. Furthermore, the company has forayed in to manufacturing of artificial leather which has favourable demand outlook. Artificial leather mainly finds application across segments like footwear, automotive interiors, furnishing, auto-replacement market and fashion accessories. There is growing awareness and acceptability for artificial leather products across these industries as compared to genuine leather, being a cheaper alternative with good aesthetic quality.

Liquidity indicator

Adequate Liquidity with working capital intensive nature of operations: The company has adequate liquidity position marked by cash flow generation of Rs.23.23 crore from operating activities in FY19 and moderate current ratio of 1.25 times as on March 31, 2019. Further, average utilisation of fund-based working capital limits during the last 12 months ending July 2019 remained moderate at 49%. However, the business operations of KGPL are working capital intensive in nature marked by elongated operating cycle of 137 days in FY19. The operating cycle of the company remained elongated due to stretched collection period.

The company expects cash accruals in the range of Rs.35-42 crore in the next 3 years as against scheduled debt repayments of Rs.10.50-15 crore.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology-Manufacturing Companies
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector

About the Company

Incorporated in 1980, Jaipur-based K G Petrochem Limited (KGPL) is promoted by Mr. G. S. Kandoi. KGPL is engaged in the manufacturing of terry fabric and garments. KGPL also works as a consignment stockist of GAIL (India) Ltd for polymers for Rajasthan under its agency division. During FY19, the company commenced manufacturing of Artificial/Synthetic PU/PVC coated leather with installed production capacity of 50 lakh meters. Terry towel segment is the major revenue earner for the company which contributed around 82% of TOI in FY19 (refers to period from April 01 to March 31). The manufacturing facility of KGPL is located at Tehsil Kotputli, near Jaipur, Rajasthan with an aggregate installed processing capacity of 6,200 Metric Tonne Per Annum (MTPA) as on March 31, 2019 while agency division is operated from unit located at Vishwakarma Industrial (VKI) Area, Jaipur. The company's stitching unit is also located in VKI area, Jaipur.

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	233.55	256.56
PBILDT	30.54	38.98
PAT	7.81	8.70
Overall gearing (times)	2.22	2.06
Interest coverage (times)	5.86	5.75

A: Audited

Status of non-cooperation with previous CRA: None

Any other information: Not applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based-Long Term	-	-	December, 2027	85.80	CARE BBB; Stable
Fund-based - LT-Cash Credit	-	-	-	6.00	CARE BBB; Stable
Fund-based - LT/ ST-Cash Credit	-	-	-	44.00	CARE BBB; Stable / CARE A3+
Fund-based - LT/ ST-EPC/PSC	-	-	-	14.00	CARE BBB; Stable / CARE A3+
Fund-based - ST-EPC/PSC	-	-	-	16.00	CARE A3+
Fund-based - ST-Standby Line of Credit	-	-	-	3.20	CARE A3+
Non-fund-based - ST-Bank Guarantees	-	-	-	5.00	CARE A3+
Non-fund-based - ST-Letter of credit	-	-	-	8.00	CARE A3+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Term Loan-Long Term	LT	77.68	Suspended	-	-	-	1)Suspended (02-Dec-16)
2.	Non-fund-based - ST-Bank Guarantees	ST	5.00	Suspended	-	-	-	1)Suspended (02-Dec-16)
3.	Fund-based - LT-Cash Credit	LT	13.00	Suspended	-	-	-	1)Suspended (02-Dec-16)
4.	Fund-based - ST-EPC/PSC	ST	43.20	Suspended	-	-	-	1)Suspended (02-Dec-16)
5.	Term Loan-Long Term	LT	1.98	Suspended	-	-	-	1)Suspended (02-Dec-16)
6.	Fund-based-Long Term	LT	85.80	CARE BBB; Stable	-	-	-	-
7.	Fund-based - LT-Cash Credit	LT	6.00	CARE BBB; Stable	-	-	-	-
8.	Fund-based - LT/ ST-Cash Credit	LT/ST	44.00	CARE BBB; Stable / CARE A3+	-	-	-	-
9.	Fund-based - LT/ ST-EPC/PSC	LT/ST	14.00	CARE BBB; Stable / CARE A3+	-	-	-	-
10.	Fund-based - ST-EPC/PSC	ST	16.00	CARE A3+	-	-	-	-
11.	Fund-based - ST-Standby Line of Credit	ST	3.20	CARE A3+	-	-	-	-
12.	Non-fund-based - ST-Bank Guarantees	ST	5.00	CARE A3+	-	-	-	-
13.	Non-fund-based - ST-Letter of credit	ST	8.00	CARE A3+	-	-	-	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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