KG Petrochem Limited (Revised)

October 05, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long term Bank Facilities	74.37 (Reduced from 91.80)	CARE BBB; Stable (Triple B; Outlook: Stable)	Reaffirmed
Long term/Short term Bank Facilities	84.00 (Enhanced from 58.00)	CARE BBB; Stable / CARE A3+ (Triple B ; Outlook: Stable / A Three Plus)	Reaffirmed
Short term Bank Facilities	4.70 (Reduced from 5.00)	CARE A3+ (A Three Plus)	Reaffirmed
Short term Bank Facilities	0.00		Withdrawn
Total Facilities	163.07 (Rs. One Hundred Sixty-Three Crore and Seven Lakhs 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) continue to 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 reputed clientele. The ratings further, derive strength from 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, continue to remain constrained on account of its leveraged capital structure and foreign exchange fluctuation risk associated with export receivables. The ratings further are constrained on account of non-stabilisation of operations of artificial leather unit, 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.

Rating Sensitivities

Positive Factors

- Significant increase in Total Operating Income (TOI) beyond Rs.400 crore through greater geographical diversification and stabilisation of operations of artificial leather unit.
- Improvement in capital structure marked by overall gearing below 1 time.

Negative Factors

- Significant decline in total operating income from envisaged level
- Decline in PBILDT margin below 10% on a sustained basis along with moderation in its debt coverage indicators
- Elongation of working capital cycle beyond 150 days on sustained basis.

Detailed description of key rating drivers

Key rating strengths

Experienced promoters: KGPL was promoted by Mr. G. S. Kandoi, a Mechanical Engineer from BITS Pilani having vast experience of more than five decades. Mr. Manish Singhal, an IIT graduate and presently Managing Director, is the son of Mr. G. S. Kandoi and has total experience of around 16 years. The Board of Directors consists of three independent directors and two whole time directors as well as experienced 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 stockist of GAIL (India) Limited for polymers for Rajasthan region. Further, the company has also started manufacturing of artificial leather in FY19.

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

Increase in Total Operating Income with healthy profitability margins: Total Operating Income of KGPL has increased by 31.55% to Rs.337.52 crore in FY20 over FY19 on account of increase in sales volume of its products (terry towel and artificial leather) as well as increase in average sales realisation on artificial leather. Sales volume of terry towels increased by 26% in FY20 on y-o-y basis on account of higher sale of low value added products. Further, sales volume of artificial leather increased by 74% in FY20 on y-o-y basis following commencement of production from second line.
PBILDT margins have inherently remained higher 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 from time to time. The company has in-house weaving, printing, designing and embroidery facilities. PBILDT margin improved marginally by 28 bps to 15.47% in FY20 on account of higher export incentives and foreign exchange gains. PAT margin also improved by 179 bps to 5.18% due to higher provision for deferred tax assets. The company reported an increase of 15.12% in Gross cash accruals (GCA) to Rs.31.97 crore in FY20 over FY19. During FY20, the company has written off incentives received under Merchandise Export Incentive Scheme (MEIS) to the tune of Rs.5.48 crore following discontinuation of MEIS scheme by Government of India with effect from March 07, 2019.
Further, for the plant of artificial leather, the company is entitled for various incentives and subsidies. The company will receive 50% exemption in electricity duty from state government for five years and 7% interest subsidy under RIPS. Further, the company is entitled for capital subsidy of 15% of plant's cost.

Moderate debt coverage indicators: The debt coverage indicators of KGPL stood moderate with total debt to GCA of 4.91 times as on March 31, 2020 as against 5.04 times as on March 31, 2019; improved on account of increase in cash accruals. PBILDT interest coverage improved from 5.76 times in FY19 to 6.14 times in FY20 due to higher operating profitability.

Key rating weaknesses

Geographical as well customer concentration risk: The Company generated around 83% of TOI (77% of TOI in FY19) from exports during FY20. The company has derived around 61% (FY19: 59%) of TOI from USA and 11% (FY19: 10%) of TOI from Chile in FY20. Further, revenue of the company continued to remain concentrated with top two customers, viz. Walmart Inc. and Saturday Knight Limited which contributed around 36% (FY19: 33%) to the TOI of FY20, though the same 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 client which enables repeat business from them.

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. Further, prices of cotton yarn are also dependent on demand-supply scenario in domestic as well international market. Cotton yarn prices, which were already under pressure in FY20, are expected to decline further in FY21. 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. The Government of India discontinued MEIS scheme with effect from March 07, 2019. However, the company is receiving other incentives from Govt. which include duty draw back, duty credit scripts, Rebate on State Levies (ROSL) scheme.

Leveraged capital structure: The capital structure of KGPL remained leveraged with overall gearing of 1.82 times as on March 31, 2020; though improved from 2.06 times as on March 31, 2019 on account of accretion of profit to reserves.

Stabilization risk associated with operations of artificial leather unit
During FY18, the company had undertaken green-field project to foray into manufacturing of artificial leather in two phases. Phase-I of the said project was completed July, 2018 whereas phase-II was completed in November, 2019. Although, both the production lines are operational, plant is yet to stabilize its operations. The company has incurred Rs.15.71 crore towards the phase –II of the project funded through term loan of Rs.11.70 crore and remaining through internal accruals as against envisaged cost of Rs.18.67 crore.
Further, the company had undertaken project for backward integration through installation of weaving plant for manufacturing of fabric for artificial leather at total cost of Rs.13.04 crore to be funded through term loan of Rs.9.75 crore and remaining through internal accruals. Till September 16, 2020, the company has incurred Rs.4.55 crore towards

construction of factory building. However, the company has put the project on hold due to covid-19 pandemic and sanctioned term loan of Rs.9.75 crore for the said project has been cancelled by the lender.

Foreign exchange rate fluctuation risk largely mitigated through prudent hedging mechanism though raw material prices fluctuation risk persists: The export sales constituted around 83% of TOI of KGPL in FY20; increased from 77% in FY19. KGPL hedges its 90% to 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 cash credit limit in the form of PCFC for pre-shipment / post shipment advance to hedge against foreign exchange rate fluctuation. During FY20, the company earned foreign exchange gain of Rs.4.64 crore as against foreign exchange gain of Rs.4.07 crore in FY19.
Further, price of its key raw material, i.e., cotton yarn which constituted around 82% (93% in FY19) of total raw material cost consumed in FY20, has been increasing continuously for last three financial years ending FY20. The company's profitability margins remain exposed to any sharp movement in its key raw material prices.

Impact of Covid-19 pandemic
The plants' operations were completely closed from March 22, 2020 due to lockdown announced in the country on account of outbreak of COVID-19 pandemic. The company resumed operations at its terry towel manufacturing plant from April 15, 2020 and artificial leather manufacturing plant from May 08, 2020. Initially the plants were operating at lower capacity due to shortage of manpower following migration of labours. However, the capacity utilisation of the plants increased by the end of June, 2020 and is currently operating at 85-90% of pre-covid level. The performance of the company during Q1FY21 has largely been impacted due to Covid-19 pandemic. However, the company has not availed moratorium announced by RBI.
TOI of the company declined by 71.49% to Rs.25.84 crore in Q1FY21 on y-o-y basis on account decline in sale of terry towel as well as artificial leather divisions following lockdown and closure of production facilities for around 26-49 days. Further with decline in scale of operations, PBILDT margin declined by 558 bps to 10.22% in Q1FY21 on y-o-y basis. Subsequently, the company has reported net loss of Rs.1.86 crore in Q1FY21 as against PAT of Rs.5.50 crore in Q1FY20. However, despite net loss in Q1FY21, the company has reported GCA of Rs.1.40 crore (Rs.10.03 crore in Q1FY20). Further, the company expects decline in scale of operations in FY21 on y-o-y basis though the same is expected to be around the levels reported in FY19. As informed by the management, the company has orders of around Rs.120 crore in hand which are expected to be executed by January 31, 2021.

Industry Outlook
The demand for textiles will face headwinds in both the markets, domestic and international. The outbreak of covid-19 has impacted sales across retail stores and malls in domestic market during current year. On the international front, the outbreak of Covid-19 is expected to keep the textiles demand under pressure in China thus hurting the Chinese cotton yarn and polyester markets. Cotton yarn prices, which were already under pressure in FY20, are expected to decline further in FY21. However, cotton being a seasonal crop, major procurement by spinning mills happens till February/ March, thereby fixing their procurement costs. With yarn realization expected to decline, and majority of the procurement cost already fixed, the spread and profitability margins of the industry players are expected to witness a further deterioration. Going forward the textile industry scenario will depend on how the situation evolves in the domestic and international markets and faster return to normalcy will enable the industry to curtail the damages and improve on its growth prospects. The outbound shipment of RMG/apparels (the largest segment in India's total textile exports) is also expected to take a hit. This is because India's export scenario remains depressed for the top export destinations, European markets (including UK) and US (they together account for about 60% of the total apparel exports) given the spread of Covid-19 in these markets and the lockdown situation there. In the medium to long term, some demand from the US and the EU markets is expected to shift (though gradually) from China to other major garment manufacturers viz. Vietnam, Bangladesh, India and Cambodia, as the customers will like to decrease their dependence on China. Large companies having sufficient liquidity cushion in the form of cash & liquid investment and/ or unused working capital lines are expected to be better placed compared to their counterparts with limited liquidity cushion and holding large inventories.

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. However, demand from domestic automotive, footwear and replacement market has remained subdued in FY20 and has further declined in 5MFY21 due to Covid-19 pandemic. Demand for artificial leather will be affected in FY21 due to subdued demand from end user industries.

Liquidity Analysis

Adequate Liquidity despite working capital intensive nature of operations: The company has adequate liquidity marked by cash flow generation of Rs.20.53 crore from operating activities in FY20 and moderate current ratio of 1.24 times as on March 31, 2020. Further, average utilisation of fund-based working capital limits during the last 12 months ending July 2020 remained moderate at 71.12%. However, the business operations of KGPL are working capital intensive in nature marked by elongated operating cycle of 119 days in FY20 which improved from 137 days in FY19. The operating cycle of the company remained elongated due to stretched collection period as well as high inventory holding.

As on March 31, 2020, the company has cash and bank balances of Rs.0.40 crore. Further, the company expects cash accruals in the range of Rs.24-33 crore in the next 3 years as against scheduled debt repayments of Rs.12-16 crore. Further, it may be noted that, the company has not availed the moratorium granted by the lenders as a COVID relief measure (as permitted by the Reserve Bank of India) for its debt obligations.

Analytical Approach: Standalone

Applicable Criteria

Policy on Withdrawal of ratings
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology-Manufacturing Companies
Rating Methodology for Cotton Textile Manufacturing
Liquidity Analysis of Non-financial sector entities
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 towel and garments. KGPL also works as a consignment stockist of GAIL (India) Ltd for polymers for Rajasthan under its agency division. The company is also engaged in manufacturing of Synthetic PU/PVC leather. Terry towel segment is the major revenue earner for the company which contributed around 79% (82% of TOI in FY19) of TOI in FY20 (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 capacity of 6,200 Metric Tonne Per Annum (MTPA) for terry towel division and 100 lakh meters for Synthetic PU/PVC leather as on March 31, 2020 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.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	256.56	337.52
PBILDT	38.98	52.22
PAT	8.70	17.47
Overall gearing (times)	2.06	1.82
Interest coverage (times)	5.75	6.14

A: Audited

During Q1FY21, KGPL reported TOI of Rs.25.84 crore with net loss of Rs.1.86 crore as against TOI of Rs.90.65 crore with PAT of Rs.5.50 crore respectively in Q1FY20.

Status of non-cooperation with previous CRA: None

Any other information: Not applicable

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

Complexity level of various instruments rated for this company: Annexure 3

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 - LT-Term Loan	-	-	December, 2027	72.37	CARE BBB; Stable
Fund-based - LT-Cash Credit	-	-	-	2.00	CARE BBB; Stable
Fund-based - LT/ ST-Post Shipment Credit	-	-	-	36.00	CARE BBB; Stable / CARE A3+
Fund-based - LT/ ST-EPC/PSC	-	-	-	48.00	CARE BBB; Stable / CARE A3+
Fund-based - ST-EPC/PSC	-	-	-	0.00	Withdrawn
Fund-based - ST-Standby Line of Credit	-	-	-	0.00	Withdrawn
Non-fund-based - ST-Bank Guarantees	-	-	-	4.70	CARE A3+
Non-fund-based - ST-Letter of credit	-	-	-	0.00	Withdrawn

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	72.37	CARE BBB; Stable	-	1)CARE BBB; Stable (25-Sep-19)	-	-
2.	Fund-based - LT-Cash Credit	LT	2.00	CARE BBB; Stable	-	1)CARE BBB; Stable (25-Sep-19)	-	-
3.	Fund-based - LT/ ST-Post Shipment Credit	LT/ST	36.00	CARE BBB; Stable / CARE A3+	-	1)CARE BBB; Stable / CARE A3+ (25-Sep-19)	-	-
4.	Fund-based - LT/ ST-EPC/PSC	LT/ST	48.00	CARE BBB; Stable / CARE A3+	-	1)CARE BBB; Stable / CARE A3+ (25-Sep-19)	-	-
5.	Fund-based - ST-EPC/PSC	ST	-	-	-	1)CARE A3+ (25-Sep-19)	-	-
6.	Fund-based - ST-Standby Line of Credit	ST	-	-	-	1)CARE A3+ (25-Sep-19)	-	-
7.	Non-fund-based - ST-Bank Guarantees	ST	4.70	CARE A3+	-	1)CARE A3+ (25-Sep-19)	-	-

8.	Non-fund-based - ST-Letter of credit	ST	-	-	-	1)CARE A3+ (25-Sep-19)	-	-

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Term Loan	Simple
3.	Fund-based - LT/ ST-EPC/PSC	Simple
4.	Fund-based - LT/ ST-Post Shipment Credit	Simple
5.	Fund-based - ST-EPC/PSC	Simple
6.	Fund-based - ST-Standby Line of Credit	Simple
7.	Non-fund-based - ST-Bank Guarantees	Simple
8.	Non-fund-based - ST-Letter of credit	Simple

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

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