ICRA

ACKNIT INDUSTRIES LIMITED

Website
www.icra.in

Rating

ICRA has revised upwards the long term rating assigned to the Rs. 42 crore[1] cash credit, Rs. 4.3 crore term loan and Rs. 1 crore non-fund based bank limits of Acknit Industries Limited (AIL / the company)[2] from [ICRA]BB+ (pronounced ICRA double B plus) to [ICRA]BBB- (pronounced ICRA triple B minus). The outlook on the long term rating is stable. ICRA has also revised upwards the short term rating assigned to the Rs. 7.74 crore non fund based bank limits of AIL from [ICRA]A4+ (pronounced ICRA A four plus) to [ICRA]A3 (pronounced ICRA A three).

Refer to Annexure I *for rating table*

Key Financial Indicators

	2013-14 Audited	2014-15 Audited	Apr'15-Dec'15 Unaudited
Net Sales	123.93	138.48	107.85
Operating Income (OI)	134.30	148.72	116.65
OPBDIT	7.77	5.74	7.42
Profit After Tax (PAT)	2.58	2.92	2.35
Net Cash Accruals	3.86	3.93	3.63
Total Debt (TD)	44.39	54.24	-
Tangible Net worth (TNW)	24.65	27.11	-
OPBDIT/OI	5.79%	3.86%	6.36%
PAT/OI	1.92%	1.96%	2.02%
PBIT/Average (TD+TNW+DTL-CWIP)	9.55%	10.65%	-
Total Gearing	1.80	2.00	-
OPBDIT/Interest & Finance Charges	3.12	1.51	2.45
(GCF+ Interest)/Interest	(1.04)	0.36	-
NCA/Total Debt	9%	7%	-
Total Debt/OPBDITA	5.71	9.45	-
Debtor days	66	55	-
Inventory days	96	97	-
Creditor days	56	34	-
NWC/OI	38%	39%	-

Note: Amounts in Rs. Crore; OI: Operating Income; OPBDIT: Operating Profit before Depreciation, Interest and Tax; PAT: Profit after Tax; PBIT: Profit before Interest and Tax; DTL: Deferred Tax Liability; CWIP: Capital Work in Progress; GCF: Gross Cash Flows; NCA: Net Cash Accruals; NWC: Net Working Capital

[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.*

Key Rating Considerations

Credit Strengths

- Near-term plan of equity infusion of a sizeable amount, relative to the current equity base, likely to have a favourable impact on capital structure
- Continuing top-line growth witnessed in 2014-15 and in the current fiscal, aided by scaling up of the readymade garment segment and overall capacity addition on a regular basis in recent years
- Longstanding presence in the industrial safety products industry
- Reputed client base coupled with diverse and flexible product mix strengthens market position; increasing presence in new geographies has reduced dependence on European markets

Credit Challenges

- Competitive nature of the industry and low bargaining power against established clients limits pricing flexibility, leading to modest profit margins and debt coverage indicators, notwithstanding high export incentives received from the Government
- High working capital intensity adversely impacts liquidity position of the company
- Exposure to risks arising from fluctuations in foreign currency exchange rates; however, the same is largely mitigated by natural hedging and forward contract hedging practices

Rating Rationale

The upward revision of ratings primarily takes into account AIL's near-term plan of equity infusion of a sizeable amount, relative to the current equity base, which is likely to have a favourable impact on the company's capital structure, which remains highly leveraged at present. Moreover, the company has witnessed growth in top-line in 2014-15 and in the current fiscal on the back of scaling up of the readymade garment segment and an overall capacity addition on a regular basis in recent years. The ratings also continue to draw comfort from AIL's longstanding presence in the industrial safety products industry, as well as its reputed client base, which coupled with diverse and flexible product mix strengthens its market position. Moreover, ICRA also takes note of AIL's increasing presence in new geographies, thereby reducing its dependence on the European markets. The company is entitled to receive incentives from the Government of India for exports of safety products. However, the intense competition in the industry coupled with AIL's low bargaining power against its established clients limits pricing flexibility, leading to modest profit margins and debt coverage metrics. Moreover, the company would be undertaking part debt funded capex for further capacity expansion, which, is likely to keep debt coverage indicators under pressure going forward. Additionally, the high working capital intensity of the company's operations adversely impacts its liquidity. ICRA also takes note of the sensitivity of the company's profitability to fluctuations in foreign currency exchange rates, although the same is mitigated to a considerable extent by natural hedging and forward contract hedging practices adopted by the company. In ICRA's opinion, the ability of the company to manage its working capital requirements while scaling up the operations and improve profitability from the business would be key rating sensitivities going forward.

Business and Competitive Position

Experience of more than two decades of the promoters in the industrial safety products industry

AIL has been involved in the production and export of industrial safety gloves and garments, which are considered essential elements in minimizing health-related risks at the workplace, for over two decades. Exports accounted for about 75% of the net sales of the company in 2014-15. It also has a presence in children's fashion garments, which are sold primarily in the domestic market.

Reputed client base coupled with diverse and flexible product mix strengthen market position; increasing presence in new geographies reducing dependence on European markets

AIL has a reputed and established client base which generates repeat orders and reduces counterparty risks. The company's diverse range of products, encompassing various types of protective wear like industrial leather gloves, cotton & synthetic gloves, coated & dotted gloves, industrial garments, etc. provides a cushion to an extent against adverse market conditions in any particular segment. Moreover, AIL has tapped customers in new geographies, including USA and middle-east countries, thereby reducing its dependence on the European markets. This has helped the company maintain its export levels, amidst a decline in the value of exports from India for leather products which generates a major portion (62% in 2014-15) of the country's revenues.

Export incentives given by the Government of India largely supports profitability, although the competitive industry and low bargaining power against large clients reduces pricing flexibility

The company receives a significant amount of export incentives from the Indian Government, which supports its profitability. However, the intense competition in the international safety-wear industry, due to the low value added nature of the products and AIL's limited bargaining power against the large overseas clientele negatively impact the company's pricing flexibility.

Exposure to risks arising from fluctuations in currency exchange rates, although hedging strategy adopted by the company mitigates the risks to a considerable extent

Although most of AIL's sales contracts are denominated in foreign currencies, exposing it to risks arising from volatility in exchange rate movements, however, utilization of export packing credit in foreign currency as well import of some amount of raw material requirement mitigates such risk to a considerable extent. Additionally, the company also books forward contracts for the balance export receivables, in order to ensure full hedging of the exchange rate fluctuation risks.

Financial Position

Continuing revenue growth in 2014-15 and in the current fiscal, led by scaling up of the readymade garment segment and overall capacity addition in the recent past; profitability, however, remains low

AIL's operating income (OI) grew by 11% in 2014-15, and stood at Rs. 148.72 crore vis-à-vis Rs. 134.30 crore in the preceding year, primarily aided by incremental revenue generated from the readymade garment segment which is largely catered to the domestic market. In the first nine month of the current fiscal (9M, 2015-16), the company's top-line registered a growth of 9% vis-à-vis the corresponding period of 2014-15, and stood at Rs. 116.65 crore, aided by the capacity expansion in recent past which positively impacted sales volumes. Additionally, AIL had an outstanding order book of around of Rs. 52 crore as on November 30, 2015, which provides revenue visibility for the company in the near term. However, net margin of the company continues to remain low at 2.02% in 9M, 2015-16 (1.96% in 2014-15) due to the low value accretive nature of operations coupled with depreciation and interest burden.

Modest level of profitability continues to keep debt protection metrics weak; though the capital structure is likely to improve, given the company's near-term plan of equity infusion

AIL's debt burden majorly comprises working capital loans at present. The company's capital structure has remained aggressive in the recent years, with an increasing trend in gearing which stood at 2 times as on March 31, 2015. Low profitability and significant debt burden continued to keep the company's debt coverage metrics weak in 2014-15, as reflected by the interest coverage of 1.51 times (2.45 times in 9M, 2015-16), net cash accrual relative to total debt of 7%, and total debt relative to OPBDITA of 9.45 times.

Nevertheless, ICRA notes that, the company has planned a significant amount (around Rs. 12 crore) of equity infusion, through 'rights issue', in the near term, which is likely to result in a considerable decline in the gearing. A major portion of the interest bearing unsecured loan, being availed by the company at present to partly meet its working capital requirement, is likely to be paid-off post the proposed equity infusion. However, the fresh term loan availed by the company for part funding of its further capital expenditure in the near-term, would lead to additional debt servicing obligation.

High working capital intensity of operations due to high inventory requirement negatively impacts liquidity

The company's operations are characterized by significant working capital intensity since its export business requires considerable inventory levels and also has an extended receivables cycle, as reflected by the NWC/OI of 38-39% in the last two years, which in turn led to negative fund flow from operations. This, along with the interest burden, dividend payout and capex incurred by the company also resulted in negative free cash flows.

Company Profile

Acknit Industries Limited was founded in 1990 as a private limited company involved in the manufacture of seamless knitted hand gloves for industrial use. The entity was converted into a limited concern under the name Acknit Knitting Limited in 1994, and entered the capital market in 1995. The name of the company was changed to the current one, Acknit Industries Limited in 2007. The company gradually diversified its product range to include leather, coated and dotted industrial gloves, as well as protective industrial garments and children's garments. It has four manufacturing units in West Bengal, with two being located in the Falta Special Economic Zone (FSEZ), Sectors I & II, and two being located in Ganganagar. Additionally, the company also operates a windmill in Dhule, Maharashtra.

Recent Results

During the first nine months of the current fiscal (Apr'15 – Dec'15), the company posted a net profit of Rs. 2.35 crore (unaudited) on an operating income of Rs. 116.65 crore (unaudited). In 2014-15, the company reported a net profit of Rs. 2.92 crore on an operating income of Rs. 148.72 crore.

March 2016

Annexure: Rating

Instrument	Amount Rated	Rating Action
Fund Based Limit – Cash Credit*	Rs. 42 crore	[ICRA]BBB- (Stable) upgraded
Fund Based Limit – Term Loan	Rs. 4.3 crore	[ICRA]BBB- (Stable) upgraded
Non-Fund Based Limit – Bank Guarantee	Rs. 1 crore	[ICRA]BBB- (Stable) upgraded
Non-Fund Based Limit – Letter of Credit	Rs. 5.5 crore	[ICRA]A3 upgraded
Non-Fund Based Limit – Forward Contract	Rs. 2.24 crore	[ICRA]A3 upgraded

*100% interchangeable to export packing credit, foreign bill discounting