June 30, 2022

KH Exports India Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Letter of Credit	70.00	70.00	[ICRA]A1+; Reaffirmed
Credit Exposure Limit / Loan Equivalent Risk	12.00	12.00	[ICRA]A1+; Reaffirmed
Bank Guarantee^	(5.00)	(5.00)	[ICRA]A1+; Reaffirmed
Untied Limits	43.00	43.00	[ICRA]A1+; Reaffirmed
Total	**125.00**	**125.00**	

**Instrument details are provided in Annexure-1, ^sublimit of Letter of Credit*

Rationale

The rating reaffirmation of KH Exports India Private Limited (KHEIPL/the company) favourably takes into consideration its established position as one of India's largest leather footwear and apparel exporters, its long relationship with globally reputed brands, considerable experience of its promoters and the integrated nature of its operations with an in-house tannery, sole manufacturing and lining facilities. KHEIPL's turnover reached the pre-Covid level in FY2022, supported by a recovery in demand of leather products since Q2 FY2022. With the order pipeline remaining adequate, KHEIPL's revenues are expected to witness healthy growth in the near term, early trends of which can be seen from the revenue of ~Rs. 240 crore recorded in April-May of FY2023 against ~Rs. 140 crore recorded during the same period last year. The rating derives comfort from KHEIPL's comfortable financial profile, characterised by its strong liquidity position, healthy capital structure and comfortable debt protection metrics with the company remaining debt free. ICRA notes that the company's prudent working capital management (reflected by NWC/OI[1] of 16% in FY2022) stands out over its peer set and supports its liquidity profile, which in turn help it to report consistently positive retained cash flows across business cycles.

The ratings are, however, constrained by KHEIPL's decline in profit margins to 4.1% in FY2022 against 7.3% in the pre-Covid year of FY2019, largely affected by a substantial increase in labour costs amid increment in minimum wage prescribed under relevant labour laws in Tamil Nadu in June 2021. ICRA notes that the company is under discussion with customers to pass on the labour cost increases, but a full-pass through is unlikely in the current year, which is likely to keep the operating profit margins below the long-period average levels (~8% between FY2017 and FY2020) in FY2023 as well. The rating also factors in the resilience of the company's operating model to periods of deep downturns, as witnessed in FY2021. Despite a 45% fall in revenues in FY2021, KHEIPL reported net profits, aided by various cost control measures undertaken by the company, including a significantly lower director remuneration. The company's margins are also impacted by the volatility in leather prices, although its ability to partly pass on the price increase to its customers mitigates the risk to a large extent. The ratings also reflect KHEIPL's relatively high customer concentration risk and its weak bargaining power against large international customers. Besides, limited presence of own branded product limits its scope for margin improvement. The company is also exposed to geographical concentration risks with the major portion of its exports made to the US and European markets. With ~65-70% of the revenues coming from the US markets, the company remains susceptible to demand cyclicality in the end-user markets. KHEIPL is also prone to regulatory risks and the resultant operational disruption, with restrictions on sourcing of animal hides and stringent pollution control norms on effluents (generated during the tanning process).

[1] Net Working Capital / Operating Income

Key rating drivers and their description

Credit strengths

Established player led by experienced promoters – KHEIPL is one of the largest players in the Indian leather exports industry with a track record of more than seven decades. Although the company is a family promoted business, the fact remains that the promoters of the company have extensive experience in the industry.

Reputed clientele comprising top global brands in the industry – The company has an established customer base comprising reputed brands like Coach Manufacturing, Cole Haan, Prada, Marks & Spencer, Ralph Lauren Corporation, Tory Burch etc. KHEIPL's customer churn rate has remained minimal over the years, indicating healthy relationships with its clients.

Integrated operations, with the Group having its own tannery, sole manufacturing and lining facilities – The integrated nature of the company's operations, with in-house tannery, manufacturing and lining facilities, leads to cost benefits arising from bulk procurement. This ensures quality control and helps capture value addition across the supply chain. It also helps maintain quality of products and timeliness of orders.

Strong credit indicators – KHEIPL's financial profile continues to be healthy, characterised by nil external debt, comfortable coverage indicators and debt protection metrics. Further, the company reported marginal improvement in profitability metrics from FY2021 however, it is yet to attain the pre-Covid profitability levels. With steady free cash flow generation over the years, KHEIPL's financial profile has remained comfortable, marked by a healthy capital structure and robust coverage indicators with an interest cover of 9.1 times as on March 31, 2022.

Credit challenges

Exposed to volatility in leather prices and rising labour costs – The company imports a large portion of its leather requirements and, thus is exposed to volatility in leather import prices. Additionally, it witnessed a significant increase in labour costs in FY2022 largely due to rise in minimum wage prescribed under relevant labour laws in Tamil Nadu in June 2021. ICRA notes that the company is under discussion with customers to pass on the labour cost increases, but a full-pass through is unlikely in the current year, which is likely to keep the operating profit margins below the long-period average levels (~8% between FY2017 and FY2020) in FY2023 as well.

High customer concentration risk – The company faces high customer concentration risk with its top three customers accounting for ~50-65% of its revenues. However, the company enjoys an established relationship with these marquee customers, which have been awarding it with repeat businesses. That said, association with reputed brands restricts its bargaining power. Limited presence of its own branded products (~1% of revenue) limits its scope for margin improvement.

High geographical concentration and exposure to demand cyclicality –The company is exposed to geographical concentration risks as the major portion of its exports are made to the US and European markets. With ~65-70% of the revenues coming from the US markets, the company remains susceptible to demand cyclicality in the end-user markets. The company witnessed an improvement in order flow from the US and European markets from Q2 FY2022 after a 45% decline in sales in FY2021.

Exposure to changes in environmental regulations, power and labour issues – The industry is prone to regulatory risks with restrictions on sourcing of animal hides and stringent pollution control norms on effluents generated during the tanning process. The manufacturing process, being labour and power intensive, is also susceptible to issues related to power shortage and labour demands.

Liquidity position: Strong

KHEIPL's liquidity position is strong with unencumbered cash and liquid investment worth Rs. 33 crore as on March 31, 2022 coupled with its debt-free status and moderate capex plans. Further, its modest working capital intensity driven by efficient receivable and inventory management enables KHEIPL to maintain a strong liquidity position. The liquidity is also supported by moderate utilisation of non-fund-based limits in the recent months (average of 38% between October 2021 and May 2022).

Rating sensitivities

Positive factors – Not Applicable

Negative factors – Pressure on the ratings could arise if there is a sustained decline in revenue or weakening of profitability, or if any adverse change in the regulations impacts the sector. The ratings could also come under pressure if a stretch in the working capital intensity impacts the liquidity profile of the company. Specific credit metric that could lead to ratings downgrade include an interest coverage below 7.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone financial statement of the issuer

About the company

KHEIPL was incorporated as Rabia Leather Industries Ltd. in 1985 and is a 100% export-oriented company with an ISO 9001-2000 certification. The KH Group traces its origins to the tannery business set up by Mr. Khizar Hussain in 1947. Over the years, the Group has expanded manifold to include numerous companies involved in the manufacturing of different leather products. Between FY2014 and FY2016, the Group undertook a restructuring exercise, whereby all major Group entities were merged with KHEIPL. This allowed the company to emerge as one of India's largest exporters of leather shoes and products. The manufacturing units of the company are spread across various locations in Tamil Nadu, namely, Poonamalle in Chennai and Ranipet in Vellore, with an overall built-up area of 17,10,000 square feet. The company possesses in-house facilities for tanning, sole manufacturing, lining and shoe assembling. The manufacturing units have the capacity to process 25 million sq. ft. of leather and manufacture up to 2 million pairs of full shoes, 1.5 million bags, 4.5 million small leather goods (wallets, key chains), 1.8 million belts and 2 million gloves, per annum.

Key financial indicators

KHEIPL (Standalone)	FY 2020 (Audited)	FY2021 (Audited)	FY2022 (Provisional)
Operating Income (Rs. crore)	1300.9	713.6	1298.6
PAT (Rs. crore)	51.1	0.5	20.3
OPBDIT/OI (%)	6.8%	3.3%	4.1%
PAT/OI (%)	3.9%	0.1%	1.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.4	0.7
Total Debt/OPBDIT (times)	0.0	0.0	0.0
Interest Coverage (times)	20.7	7.0	9.1

Source: KHEIPL Audited/Provisional Financials; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Jun 30, 2022	Nov 22, 2021	Nov 05, 2021	Mar 08, 2021	Feb 17, 2020
1	Letter of Credit	Short Term	70.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Credit Exposure Limit/ Loan Equivalent Risk	Short Term	12.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Bank Guarantee*	Short Term	(5.00)	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Untied Limits	Short Term	43.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+

*Source: Company Data, *sublimit of Letter of Credit*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Letter of Credit	Very Simple
Credit Exposure Limit/ Loan Equivalent Risk	Very Simple
Bank Guarantee	Very Simple
Untied Limits	NA

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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Letter of Credit	NA	NA	NA	70.00	[ICRA]A1+
NA	Credit Exposure Limit/ Loan Equivalent Risk	NA	NA	NA	12.00	[ICRA]A1+
NA	Bank Guarantee*	NA	NA	NA	(5.00)	[ICRA]A1+
NA	Untied Limits	NA	NA	NA	43.00	[ICRA]A1+

*Source: Company Data, *sublimit of Letter of Credit*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not Applicable		

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About ICRA Limited:

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