Rating Rationale

Armstrong Knitting Mills

08Aug2019

Brickwork Ratings upgrades the long term rating to BWR BB and reaffirms the short term rating at BWR A4 for the enhanced bank loan facilities of Rs. 67.79 Crore of Armstrong Knitting Mills *['AKM' or 'the Firm']*, Tirupur, Tamilnadu

Particulars

Facilities	Amount (Rs. Cr)		Tenure	Ratings*	
	Previous	Present		Previous	Present
Fund Based					
Term Loan	8.17	4.04	Long Term	BWR BB- (Pronounced as BWR Double B Minus) Outlook: Stable Upgraded	**BWR BB** (Pronounced as BWR Double B) **Outlook: Stable** Upgraded
Packing Credit	49.00	60.00	Short Term	BWR A4 (Pronounced as BWR A Four) Reaffirmed	**BWR A4** (Pronounced as BWR A Four) Reaffirmed
Non Fund Based					
Bank Guarantee	0.25	0.25			
CEL (ForwardContract)	--	3.50			
Total	**57.42**	**67.79**	**INR Sixty Seven Crores and Seventy Nine Lacs only**		

**Note: Annexure I provides details of the credit facilities ; *Please refer to BWR website www.brickworkratings.com/ for definition of the ratings

Rationale/Description of Key Rating Drivers/Rating sensitivities:

Brickwork Ratings has essentially relied upon the audited financials upto FY18, provisional financials for FY19 and projections upto FY20, publicly available information and information/clarifications provided by the Firm's management.

The rating revision factors the improved operational and financial performance of the Firm. The ratings continue to factor the long operational track record of the firm, industry experience of the partners spanning over four decades in the garment industry, long-term relationships with renowned domestic and international retailers over the years, which has facilitated repeat business and moderate financial risk profile. The ratings, however, remain constrained by the modest scale of operations, intensely competitive industry, vulnerability of earnings to the volatility in input prices, foreign exchange rates and/or changes in duty structure/incentives for exporters, limited pricing flexibility and working capital intensive operations. The ratings also factor the ongoing litigation with a bank in respect of certain derivative contracts entered into in earlier years (~ Rs 10 Crs), exposing the firm to high contingent liability. The outcome of the litigation may affect the profitability and the credit risk profile of the firm.

Going forward, the ability of the firm to achieve its targeted turnover and profitability, strengthen its liquidity and credit profile, ensure timely realisation of its receivables, achieve customer and geographical diversification and manage its working capital effectively would be the key rating sensitivities. Further, the developments in the ongoing derivative liability litigation and the impact of any claims & liabilities arising in this connection on the credit profile of the firm shall be a key rating sensitivity. The Firm is required to furnish timely information to BWR on the status of this matter.

Analytical Approach - Standalone

For arriving at its ratings, Brickwork Ratings has applied its rating methodology as detailed in the Rating criteria below (hyperlinks provided at the end of this rationale).

Rating Outlook: Stable

Brickwork Ratings believes that Armstrong Knitting Mills' ('AKM' or 'the Firm') business risk profile will be maintained over the medium term. The 'Stable' outlook indicates a low likelihood of rating change over the medium term. The rating outlook may be revised to 'Positive' in case the firm records significantly better-than-expected growth in revenues along with improvement in profitability levels and efficient working capital management, resulting in better debt coverage metrics and liquidity profile. The rating outlook may be revised to 'Negative' if the revenues go down, profit margins show lower than expected figures, resulting in lower than estimated coverage indicators and working capital cycle is stretched pressurizing the liquidity position or any major debt funded capital expenditure plan leads to stress on the financial risk profile of the Firm. Any adverse development in respect of the disputed derivative liability matter would result in downgrade of ratings.

Key Rating drivers

Credit Strengths:

- **Established operational track record and experienced promoters -** The Firm has an established track record with more than four-decade-long experience in manufacturing and export of apparels.
- **Strong customer base -** Over the years, the promoters have fostered relationships with leading domestic and global apparel retailers, establishing a strong client base. The Firm has been getting repeat business from these clients on a sustained basis, which has facilitated growth in its scale of operations. This also reflects favourably on the Firm's track record and competitive positioning in the apparel sector. Some of the key clients are Ayablu Inc, Loomstate (USA), Continental Clothing Company (UK), Federation of Migros (Switzerland), Sense Organics Import & Trading GMBH (Germany), etc. The top 5 clients only contribute ~63% of total sales.

- **Moderate financial risk profile** - AKM's financial risk profile is moderate with modest revenue, profitability and comfortable debt protection metrics. Net sales improved to Rs.210.25 Crs for FY18 as against Rs. 203.35 Crs in FY17. PAT for FY18 was Rs. 15.31 Crs as against Rs. 16.79 Crs during FY 17. Interest coverage was 3.78 times as on 31 Mar 2018 (4.05 times as on 31 Mar 2017). Debt coverage was 6.41 times as on 31 Mar 2018 (7.71 times as on 31 Mar 2017). Partners' Capital was Rs. 50.13 Crores as on March 31, 2018. Gearing was comfortable at 1.03 times as on 31 Mar 2018.
- **Locational advantages:** The Firm is located at Tirupur, which is a major textile hub. This provides location specific advantages in terms of easy accessibility to raw materials, clientele and availability of labour.
- **Moderate order book position-** AKM has sales orders to the extent of ~Rs 80 Crs on hand, for execution during the next 5 months.

Credit Constraints:

- **Vulnerability to volatility in raw material prices, demand trends in key export markets and exchange fluctuations -** Similar to other apparel exporters, the Firm's profitability is vulnerable to volatility in raw material prices as well as variations in foreign exchange rates. AKM faces geographical concentration risk in terms of its revenue, primarily concentrated in the USA, which accounts for ~ 40% of revenue. This makes the firm vulnerable to any adverse demand trends or developments that affect consumer spending and preferences in such markets. Seasonality inherent in the operations also exposes the company to earnings and cash flow volatility during the year.
- **Highly competitive nature of the industry and modest scale of operations -** The Firm operates in a highly competitive business environment, facing stiff competition from both organised and unorganised players. The intense competition in the industry continues to limit its bargaining power/ pricing ability, thereby constraining its margins. Further, the scale of operations of the firm is comparatively modest.
- **Geographical and customer concentration**: The top 5 customers viz. Ayablu Inc and Loomstate (USA), Continental Clothing Company (UK), Federation of Migros (Switzerland), Sense Organics Import & Trading GMBH (Germany) contribute ~63% of firm's revenue. Also, ~40% of the revenue is contributed by the US based clients. Revenues and earnings depend on the performances of its key customers, apart from other factors such as regulations and duty structures across markets. The risk is mitigated to an extent by the established relationship with its key clientele and addition of new customers in recent fiscals.

Liquidity - Stretched: Working capital utilisation remained high with an average utilisation of around 90% over the last one year, owing to the nature of business. Current ratio was 1.23 times as on 31st March 2018. Net cash accruals to total debt was around 0.41 times as on 31st March 2018. Cash & Cash equivalents were Rs. 0.27 Cr as on 31st March 2019, as reported on a provisional basis. The operations are expected to remain working capital intensive and the company is reliant on external borrowings for its operations. Timely enhancement of working capital facilities will be critical for maintaining a comfortable liquidity position.

About the Firm

Armstrong Knitting Mills (AKM), set up as a partnership firm in 1971 at Tirupur, is engaged in the manufacture and export of readymade garments and generation of solar power. The firm, certified as a 'Two-Star Export House', exports to the US and European countries viz UK, Switzerland, Germany etc. The Firm also engages in domestic sales of the export surplus. The product profile of AKM covers a wide range of products like Knitwear, Woven Garments, made ups, formal and casual attire, which caters to Men, Women, Children and Infants.

AKM has three divisions viz. Garments, Compacting, Printing & Embroidery and Solar Division. AKM at present has the capacity to manufacture 1.65 crs pieces annually and current utilisation is around 70%. Solar Plant with 2MW capacity is located in Dindigul District, Tamilnadu. Utilisation is maximum and the generated power is sold among associate concerns.

The Managing Partner is Mr.E.Palanisamy and other partners are Ms.P. Renugadevi and Mr.P.Vivekanand

Financial Performance

Key Financial Parameters

Particulars		31 Mar 2017	31 Mar 2018
		Audited	**Audited**
Net Revenue	Rs. Cr	203.35	210.25
EBITDA	Rs. Cr	12.76	11.54
Profit After Tax	Rs. Cr	16.79	15.31
Partner's Capital	Rs. Cr	42.98	50.13
Total Debt : Partner's Capital	Times	1.30	1.03
Current Ratio	Times	1.02	1.23

On a provisional basis, the Company has achieved sales of around Rs. 226 Cr during FY19. The contingent liabilities on account of the disputed derivative contracts are not disclosed in the financial statements.

Rating History for the last three years

<table>
<tr><th rowspan="2">Facilities</th><th colspan="3">Current Rating (August 2019)</th><th colspan="2">Rating History</th></tr>
<tr><th>Amount (Rs. Cr)</th><th>Type</th><th>Ratings</th><th>24Jan2018</th><th>17Nov2016</th></tr>
<tr><td colspan="2">Fund Based</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Term Loan</td><td>4.04</td><td>Long Term</td><td>BWR BB
(Pronounced as BWR Double B)
Outlook: Stable
Upgraded</td><td>BWR BB-
(Pronounced as BWR Double B Minus)
Outlook: Stable
[Upgraded]</td><td>BWR B+
(Pronounced as BWR Single B Plus)
Outlook: Stable
[Assigned]</td></tr>
<tr><td>Packing Credit</td><td>60.00</td><td rowspan="4">Short Term</td><td rowspan="4">BWR A4
(Pronounced as BWR A Four)
Reaffirmed</td><td rowspan="4">BWR A4
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[Reaffirmed]</td><td rowspan="4">BWR A4
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</table>

Status of Non-Cooperation with other CRA: NIL
Any other information: NIL

Hyperlink/Reference to applicable Criteria

- General Criteria
- Approach to Financial Ratios
- Manufacturing Companies
- Short Term Debt

Analytical Contacts	Investor Contacts
Rajee R **Senior Director - Ratings** **B: +91 80 4040 9940** **rajee.r@brickworkraings.com** **Naveen S** **Ratings Analyst** **M: +918884498561** **B: +91 80 4040 9940 Ext: 342** **naveen.s@brickworkratings.com**	**Satish Nair** **Director - Global Market Development & Investor Relations** **M: +91 7738875550** **B: +91 8067456666** **satish.n@brickworkratings.com**
1860-425-2742	

Annexure I
Bank Loan Facilities

Bank	Facilities	Type	Tenure	Amount Rated (Rs. Cr)	
				Previous	**Present**
Canara Bank Overseas Branch, Tirupur	Term Loan-1	**Fund Based**	Long Term	5.44	2.45
	Term Loan-2			2.73	1.59
	Packing Credit Sub limit: PC/PCFC Sub limit: FDB/FBE/BRD		Short Term	49.00 (26.00) --	60.00 (30.00) (30.00)
	Bank Guarantee	**Non Fund Based**		0.25	0.25
	CEL (Forward Contract)			--	3.50
			Total	**57.42**	**67.79**

For print and digital media

The Rating Rationale is sent to you for the sole purpose of dissemination through your print, digital or electronic media. While it may be used by you acknowledging credit to BWR, please do not change the wordings in the rationale to avoid conveying a meaning different from what was intended by BWR. BWR alone has the sole right of sharing (both direct and indirect) its rationales for consideration or otherwise through any print or electronic or digital media.

Note on complexity levels of the rated instrument:

BWR complexity levels are meant for educating investors. The BWR complexity levels are available at www.brickworkratings.com/download/ComplexityLevels.pdf Investors queries can be sent to info@brickworkratings.com.

About Brickwork Ratings

Brickwork Ratings (BWR), a SEBI registered Credit Rating Agency, accredited by RBI and empaneled by NSIC, offers Bank Loan, NCD, Commercial Paper, MSME ratings and grading services. NABARD has empaneled Brickwork for MFI and NGO grading. BWR is accredited by IREDA & the Ministry of New and Renewable Energy (MNRE), Government of India. Brickwork Ratings has Canara Bank, a leading public sector bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations.