

Hitex Carpet Private Limited

Rating

Facilities/ Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	595.48	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	602.65	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,198.13		

* Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned ratings of 'CARE-NP BB' to the long-term bank facilities and 'CARE-NP A4' to the short-term bank facilities of Hitex Carpet Private Limited (HCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of HCPL are constrained by its highly leveraged capital structure with modest debt service coverage indicators at the end of FY21 (Audited, refers to the twelve-month period ended mid-July 2021), working capital intensive nature of operation with stretched liquidity position and exposure to raw material volatility risk and foreign exchange fluctuation risk. The ratings also factor in HCPL's presence in a highly fragmented and competitive nature of industry and exposure to volatile interest rate.

The ratings, however, derive strength from experienced promoters with long track record in the rugs & carpet industry, increasing scale of operations and healthy gross margins, albeit low net profitability, reasonable product portfolio with growing market presence and locational advantage for procurement of raw materials and selling its products.

Going forward, the ability of HCPL to manage growth in the operations while maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Highly leveraged capital structure with modest debt service coverage indicators at the end of FY21

The capital structure of the company stood highly leveraged at the end of FY21 with debt to equity ratio of 2.45x (FY20: 2.56x) and overall gearing ratio of 5.16x (FY20: 4.36x). The deterioration in the gearing ratio at the end of FY21 was on account of higher working capital borrowings to cater increasing scale of operations. HCPL's interest coverage ratio improved to 2.31x in FY21 (FY20: 1.89x) on account of higher PBILDT generation despite increased interest outgo during the year amid increased debt levels. Total debt/ Gross Cash Accruals (GCA) also remained high at 15.68x in FY21, although improved from to 25.51x in FY20, as overall debt levels remain high relative to the current operations of the company.

With the company in process to incur additional debt funded capex during FY22 to increase its capacity to 40,00,000 sq. meters from 30,00,000 sq. meters, the gearing levels are likely to remain on the higher in the near-term. Gearing levels in excess of 4x indicates the company's modest gearing headroom to raise additional debt for its capex. However, as majority of the capex has already been completed and funding for the remaining capex is already tied-up the company's need for additional term debt is likely to remain low over the medium term.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

Working capital intensive nature of operations and stretched liquidity position

The operations of the company are working capital intensive in nature. HCPL is involved in the manufacturing of carpets majorly from imported raw materials which include yarns, latex and nylon. The overall operating cycle of the company remained elongated at around 210 days in FY21, majorly due to a high inventory holding period. The company has to make advance payment for some of the raw materials, maintain adequate inventory to avoid any stock-outs, also has to fund debtors with average collection period of around two months. All these lead to increased reliance on working capital borrowings. The average utilisation of fund-based working capital limit against drawing power was around 75% during the twelve-month period ended April 13, 2022. Furthermore, the company's liquidity profile remains stretched as indicated by current ratio of 0.84x. Efficient management of the working capital cycle leading to lower dependence on bank borrowings and improved liquidity position of the company will remain critical from credit perspective.

Raw material price volatility risk and foreign exchange fluctuation risk

The main raw materials of HCPL are Polypropylene Yarn, Polyester Spun Yarn, Jute Yarn, Latex and Nylon which are majorly imported from Turkey, Bangladesh, Indonesia, China and India. Prices of these materials are generally market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. Raw material cost contributes significantly to the company's cost structure (around 77% of the total operating income in FY21), thus, any volatility in input prices impacts the profitability of the company. The business operations of HCPL is also exposed to volatility in foreign exchange rates for purchases invoiced in foreign currency other than Indian Rupees.

Presence in fragmented and competitive nature of industry

The carpet industry is intensely competitive in nature marked by the presence of numerous big and small players in the unorganized segment. Given the fact that the entry barriers to the industry are low in terms of capital and technology requirements and limited product differentiation, the players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. The producers of carpet products are essentially price-takers in the market, which directly impacts their cash flows and profitability.

Exposure to volatile interest rates

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last 2-3 quarters. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Key Rating Strengths**Experienced promoters with long track record in the related field**

HCPL has been operating under the guidance of directors having strong background in trading of rugs and carpets in both the domestic as well as the international market. The company is managed under the overall guidance of its seven board of directors (BOD). The promoters of HCPL have experience of over three decades in the carpet industry. The BOD is supported by management team with experience in related business.

Financial risk profile marked by increasing scale and healthy gross margins, albeit low net profitability

HCPL's revenue grew by around 70% year on year (yoy) to Rs. 764 Mn, boosted by increasing demand for its carpets coupled with improving reach of the company. The growth in sales was also aided by enhanced capacity of the company during FY21, leading to increased production. Total sales quantity during FY21 increased 51% yoy to 1,728,239 square meters. PBILDT margin remained healthy at around 18% over the last couple of years (FY21:17.82 %). However, the company's net profitability has remained very nominal on account of high depreciation and internet expenses. HCPL achieved PAT of Rs. 6 Mn in FY21 with PAT margin of 0.76% as compared to Rs. 2 Mn with PAT margin of 0.42 % in FY20. Scale of operations has continued to represent growth in H1FY22 (Unaudited, refers to the six-month period ended mid-January 2022) with the company reporting revenues of Rs. 445 Mn.

Growing market presence with moderate product portfolio

The company's rugs and carpets portfolio have a wide variety in terms of quality, thickness and other different features targeted for different customer groups at various price points. A wide range of product portfolio generally provides greater attraction to customers, increases reach to a larger customer base and ultimately helps improve sales. HCPL sells its product domestically and also in India leveraging and building on the already existing distribution channel for trading business that the promoters have been involved in over the past three decades or so.

Locational advantages for procurement of raw materials and selling its products

HCPL has its corporate office and factory situated in Biratnagar, Nepal around 27 kms from the Biratnagar customs office. Since HCPL imports majority of its raw materials, the factory's proximity to the Indian border provides a competitive advantage in terms of savings in freight cost. Being close to the Indian border also benefits the company in exporting its products to the adjacent Indian states and generating export revenue to the company.

About the Company

Hitex Carpet Private Limited (HCPL) is a private limited company incorporated on April 22, 2015 for manufacturing Rugs and Carpets. HCPL is the first carpet manufacturing factory in Nepal. The manufacturing facility is located in Biratnagar, Morang, Nepal with six carpet loom machineries having installed capacity of 30,00,000 sq. meters per annum.

Brief financial performance of HCPL during last 3 years is given below:

(Rs. In Million)

Particulars	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	507	447	764
PBILDT Margin(%)	21.48	18.36	17.82
Overall Gearing (times)	3.67	4.36	5.16
Interest coverage (times)	2.06	1.89	2.31
Current Ratio(times)	0.77	0.97	0.84
Total Debt/Gross Cash Accruals(times)	14.71	25.51	15.68

A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	595.48	CARE-NP BB
Short Term Bank Facilities	Non-Fund Based Limits	602.65	CARE-NP A4
Total		1198.13	

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