Monte Carlo Fashions Limited

Instrument	Amount (Rs. Crore)	Rating Action
Long-term fund-based	136.89 (reduced from 229.29)	[ICRA]AA-(Stable) / upgraded
Long-term non fund-based	2.40 (reduced from 5.00)	[ICRA]AA-(Stable) / upgraded
Long-term unallocated	143.11 (increased from 35.71)	[ICRA]AA-(Stable) / upgraded
Short-term non fund-based	17.60 (reduced from 30.00)	[ICRA]A1+ / reaffirmed
Commercial paper[1]	100.00	[ICRA]A1+ / reaffirmed

ICRA has upgraded the long-term rating to [ICRA]AA- (pronounced ICRA double A minus) from [ICRA]A+ (pronounced ICRA A plus) for the Rs. 282.40 crore[2] fund-based and non fund-based bank limits of Monte Carlo Fashions Limited (MCFL)[†]. The outlook on the long-term rating is Stable. ICRA has also reaffirmed the short-term rating at [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 17.60 crore non fund-based bank limits and Rs. 100.00 crore commercial paper programme of MCFL.

The rating upgrade takes into account improvement in liquidity due to tie-up of additional working capital limits in relation to the peak working capital requirements. This addresses the credit concerns arising from seasonal moderation in liquidity witnessed during Q3, as tied-up working capital limits were lower than the peak working capital requirements. ICRA is aware of the increased working capital requirements of MCFL's operations during past one year, especially after the weak winter season in FY2016; however, the same has been funded through internal cash accruals as reflected in continued negative net debt position at end of FY2016, whereby the liquid investments stood higher than the debt levels. For the current year, ICRA expects the current assets to be higher on YoY basis, however, tie-up of additional working capital limits and longer credit period from suppliers shall reduce the net working capital requirements and hence result in better liquidity in upcoming peak season, i.e. Q3 FY2017. While ICRA expects the company to remain negative on net debt position by end of FY2017, however, given the weak sales growth and consequently higher inventories on YoY basis, ability to reduce the stock in upcoming season will be critical for free cash flows.

The ratings continue to be supported by the strong brand presence of the MCFL's brand, Monte Carlo, in the domestic apparel market which along with an established multi-channel distribution network and a wide product range comprising of winter and summer wear apparels for men, women and kids has resulted in steady revenue growth with healthy profitability and accruals. With no major capital expenditure planned over the medium term, ICRA expects MCFL's accruals to remain significantly higher than scheduled debt repayments and hence the accruals can fund a large proportion of the incremental working capital requirements thereby keeping the debt levels steady and financial profile healthy. The financial profile of MCFL continues to be characterised by strong capital base, low dependence upon debt during most of the year and healthy cash & equivalents (Rs. 146 crore as on March 2016). Low leverage with limited scheduled debt repayments coupled with healthy profitability and accruals continues to result in strong debt coverage with NCA/Total Debt of 61% and Total Debt/OPBDITA of 0.8x in FY2016. Also, ICRA notes that given the strong capital base, MCFL maintains negative net debt position during most of the months (~10 months) in a year.

The ratings also continue to draw comfort from the outright sale model for most of the sales with limited provision for sales return which mitigates the risk of obsolete inventory due to unsold stock and the healthy

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[1] The rating of Rs. 100 crore CP programmes is based on the condition that total borrowings by way of sanctioned working capital facilities from the banks and commercial paper will remain within a total of below mentioned items:

a) Lower of sanctioned working capital limits / Maximum Permissible Banking Finance

b) Unencumbered cash balances/ bank deposit/liquid mutual funds (investment such as equity, Fixed Maturity Plans are excluded within the definition of liquid mutual fund)

[2] 100 lakh = 1 crore = 10 million

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

growth prospects of the branded apparel industry, given the low penetration of the organized retail, India's long term economic growth outlook and favourable demographic profile. Nonetheless, ICRA takes a note of the increasing levels of finished goods inventory due to need of stocking of apparels before the season to meet the requirement of the existing stores and the new stores which are opened during the season. While the company has limited obsolete stock as per inventory aging data (which has however deteriorated subsequent to weak winters in FY2016), the ability to minimize the leftovers on a consistent basis remains critical to control the working capital and keep the inventory write-down risk low, given the fast changing fashion trends. High inventory levels coupled with credit sales to the distribution channel partners (franchisee exclusive stores and MBOs) results in high working capital intensity of operations. The free cash flows are thus sensitive to the working capital cycle, pace of growth and scale of capital expenditure. With no plan for any major capital expenditure, ability to manage the working capital cycle while targeting prudent growth remains critical to curtail borrowings, especially in the backdrop of increasing inventory levels.

The ratings also remain constrained by the seasonality in the business with more than ~55% of the revenues and profits during Q3 of the financial year as the dependence on the winter wear segment remains high, despite the expansion of the product portfolio over the last decade. Apart from posing challenges for high level of working capital, the winter wear sales also remain susceptible to the weather conditions. Short or mild winter as witnessed in FY2016 can impact the sales in both the current and subsequent season due to limited repeat orders in the current season and lower fresh orders in the subsequent season due to season leftovers with MBOs. The high dependence on the winter wear has also resulted in high geographical concentration with most of the stores and sales in northern, central and eastern regions.

Notwithstanding the established position of MCFL in the winter wear segment, MCFL faces strong competition in the summer wear segment from a number of established national and regional brands. As a result, ability to strengthen the presence in the summer wear segment remains critical for long term growth, geographical diversification and minimizing the seasonality in business; and is thus a key rating sensitivity. Also, MCFL's ability to maintain the cash-flows and liquidity profile during the peak season through efficient fund management remains critical.

Company Profile

Monte Carlo Fashions Limited (MCFL) was incorporated in July 2008 as a wholly owned subsidiary of Oswal Woollen Mills Ltd. (OWML). Pursuant to the scheme of arrangement and demerger with OWML, the apparel business of OWML under the brand Monte Carlo, comprising of manufacturing facilities, sales distribution network and the ownership of the brand were transferred from OWML to MCFL with effect from April 1, 2011 and MCFL ceased to be a subsidiary of OWML.

Monte Carlo is an established brand in the domestic apparel market, particularly in the woollen apparel segment and is retailed through a multi-channel distribution network of exclusive stores (228 stores as on June 2016 in India) and multi-brand outlets (~2,200 stores as on June 2016). The brand was launched in 1984 by OWML as an exclusive woollen brand; however over the years the product portfolio has been diversified to include summer wear as well.

MCFL is part of the Ludhiana-based Nahar Group, which is one of the largest and oldest textile groups in the country with vertically integrated operations from spinning to garmenting and retailing. The other Group companies are OWML (rated [ICRA]A+/A1+), Nahar Industrial Enterprises Ltd. (rated [ICRA]A/A1) and Nahar Spinning Mills Ltd.

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