August 20, 2021

Monte Carlo Fashions Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	125.00	125.00	[ICRA]AA- (Stable) reaffirmed
Long-term Fund-Based – Term Loan	20.34	20.34	[ICRA]AA- (Stable) reaffirmed
Long-term Unallocated	24.66	24.66	[ICRA]AA- (Stable) reaffirmed
Short-term Non-fund based (Letter of Credit)	30.00	30.00	[ICRA]A1+ reaffirmed
Long-term/ Short-term Interchangeable (Bank Guarantee)^	(10.00)	(10.00)	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed
Commercial Paper (CP)[1]	100.00	100.00	[ICRA]A1+ reaffirmed
Total	**300.00**	**300.00**	

**Instrument details are provided in Annexure-1; ^Sub-limit of cash credit*

Rationale

The rating reaffirmation factors in Monte Carlo Fashions Limited's (MCFL's or the company's) strong market position in the winter-wear segment with an established brand (Monte Carlo) and a multi-channel distribution network. Further, the ratings continue to be supported by MCFL's healthy financial risk profile characterised by a strong capital base, negative net debt position during most part of the year, robust debt coverage indicators (interest coverage of 8.6 times and debt-service coverage ratio of 4.0 times for FY2021) and a strong liquidity position. While the pandemic-led operational disruptions and resultant pressures on discretionary consumer spending resulted in a decline in the company's turnover in FY2021, steps taken to rationalise expenses helped the company report an improvement in profitability, and maintain healthy coverage metrics.

The ratings, however, continue to be constrained by the fragmented and competitive nature of the domestic apparel industry and the company's exposure to trends in consumer spending. Despite MCFL's established position in the winter-wear segment, it faces intense competition in the summer-wear segment from several established brands operating in the country. In addition, the ratings are constrained by concentration risks from its high dependence on the winter-wear segment under a single brand, which in turn drives seasonality in sales, limits geographical diversification, and makes sales vulnerable to weather conditions. The seasonality in business also results in high working capital requirements during the peak season (NWC/OI in the range of ~30-45%) due to high levels of apparel inventory and credit sales to distribution channel partners. Nonetheless, the company's reliance on the outright sale model for most of the sales with limited provision for sales returns partially mitigates the risk of obsolete inventory from unsold stock.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's expectation that a sustained recovery in demand post the second wave of the pandemic, together with a less severe impact of lockdowns seen this year, would help the company report an improvement in turnover and maintain profitability at healthy levels in FY2022, despite a subdued performance in Q1 FY2022. Coupled with low dependence upon debt and a strong liquidity position, this is expected to support its credit profile.

[1] *The rating for the Rs. 100.0-crore commercial paper programme of MCFL is based on the condition that total short-term borrowings (including commercial paper, short term debt and bank borrowings) of the company at any given point of time should not exceed the company's drawing power or the sanctioned fund based limits assigned by the company's bankers (whichever is lower).*

Key rating drivers and their description

Credit strengths

Strong brand equity in the winter-wear segment and established distribution network - MCFL manufactures and retails winter and summer-wear apparel in the domestic market under its 'Monte Carlo' brand, which is an established brand, particularly in the winter-wear segment. The company has established a pan India, multi-channel distribution network, comprising 298 exclusive brand outlets (EBOs), 1,777 multi-brand outlets (MBOs) and 622 large format stores/ national chain stores (NCSs) as on March 31, 2021, across more than 700 cities. The EBOs allow MCFL additional flexibility in promotion and brand building, enabling direct engagement with customers. The MBO channel, on the other hand, helps to expand its geographical reach with minimal investments.

Healthy financial profile characterised by strong capital base, negative net debt position and robust debt coverage indicators, with strong liquidity profile - MCFL's dependence on external borrowings has remained low because of its strong capital base and healthy accruals, which have been sufficient to meet most of its funding requirements, as also reflected in its low leverage (total debt/tangible net worth, or TNW, of ~0.2 time as on March 31, 2021). Further, the company continues to maintain sizeable free cash and liquid investments (~Rs. 228.43 crore as on March 31, 2021), which are larger than the average borrowing level of the company during the year (peaks during the third quarter of the financial year in line with sales and working capital intensity trend), resulting in negative net debt position during most months of the year. Low leverage coupled with limited debt repayments and healthy profitability results in robust debt metrics as reflected by total debt/OPBDITA of 1.0 time and interest coverage of 8.6 times for FY2021. In addition, MCFL has a strong liquidity profile, characterised by sizeable cash and liquid investment balances and adequate undrawn working capital limits during the year (average utilisation level of 23% vis-à-vis borrowing capacity[2] during the six-month period ended January 2021).

Operational and financial flexibility as part of the Nahar Group - 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 and garmenting to retailing. The other companies in the Nahar Group include Oswal Woollen Mills Limited[3], Nahar Industrial Enterprises Limited[4], Nahar Spinning Mills Limited, Nahar Capital and Financial Services Limited[5], Nahar Poly Films Limited and Vanaik Spinning Mills Limited.

Credit challenges

High brand, segment and geographical concentration risks - MCFL has expanded its product as well as brand portfolio over the years to offer a complete range of winter and summer-wear. However, it continues to face high dependence upon the winter-wear segment under a single brand (Monte Carlo). Resultantly, MCFL's sales remain vulnerable to weather conditions, with more than ~50% of its revenues being generated in the third quarter of the financial year. Moreover, due to tropical climate in the western and southern regions, the winter-wear market is limited and consequently the company has limited presence in these regions, resulting in higher revenue concentration in northern, eastern and central regions.

High working capital intensity - MCFL's business is working capital intensive due to the high levels of apparel inventory and credit sales to its distribution channel partners. The apparel inventory level is high because of its need to stock apparels before the season to meet the requirement of its existing stores as well as new stores launched during the season. Further, the working capital requirements typically peak in the second and third quarters of the financial year with high inventory in the second quarter to meet higher third quarter sales and high receivables in the third quarter. Hence, the company's ability to

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[2] *Borrowing capacity here is defined as drawing power available to the company (i.e. lower of sanctioned working capital limits or estimated drawing power) + borrowings approved against company's fixed deposits and mutual fund investments*

[3] *ICRA has rating outstanding of [ICRA]A-(Stable) and [ICRA]A2+ for Oswal Woollen Mills Limited*

[4] *ICRA has rating outstanding of [ICRA]BBB+(Stable) and [ICRA]A2 for Nahar Industrial Enterprises Limited*

[5] *ICRA has an [ICRA]A1+ rating outstanding for Nahar Capital and Financial Services Limited*

minimise non-moving stock, stock returns and receivables from the previous season on a consistent basis will remain critical to control the working capital and keep the inventory write-down risk low.

Exposure to consumer spending trends and intense competition - MCFL's sales, profitability and cash accruals, like any other apparel retailers, are closely linked to macro-economic conditions, consumer confidence and spending patterns. This has been witnessed in FY2021 as well as YTD FY2022, with the company's revenues as well as profitability getting impacted by the pandemic. Besides, its sales remain vulnerable to the consumers' changing tastes and preferences, and the competition from branded as well as fragmented apparel manufacturers. The intense industry competition mandates high marketing spends to maintain market presence, particularly when there is a demand slowdown.

Liquidity position: Strong

MCFL's liquidity position remains **Strong** with a healthy cushion in sanctioned working capital limits (average undrawn limits of Rs. 188.0 crore vis-à-vis borrowing capacity in the six-month period ended January 2021) and sizeable free cash and liquid investments (~Rs. 228.4 crore as on March 31, 2021). Moreover, the company's demonstrated ability to generate healthy cash flow from operations (Rs. 88.39 crore in FY2021), together with nominal repayment obligations (Rs. 4.6 crore in FY2022-FY2024) and no material expansion plans, is expected to help it maintain a strong liquidity profile.

Rating sensitivities

Positive factors – The long-term rating could be upgraded if the company's scale of operations grows to the extent that its competitive position is enhanced. Further, increased diversification across brands, product segments (winter-wear/summer-wear) as well as regions, facilitating reduced seasonality in revenue as well as working capital requirements and supporting a sustained improvement in return metrics, could be a positive rating trigger.

Negative factors – The ratings could be downgraded if there is a sustained pressure on the company's revenues and profitability, aggressive debt-funded investments/ acquisitions or a significant stretch in its working capital cycle, which weakens its liquidity profile and/or results in an increase in its leverage. Specific metrics include Total Debt/ OPBIDTA of more than 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for entities in the Textiles Industry- Apparels
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

MCFL is a Ludhiana-based manufacturer and retailer of apparels. The company retails its products under the 'Monte Carlo' brand, which is an established brand in the domestic apparel market, particularly in the winter-wear segment. MCFL had an established multi-channel distribution network of 298 EBOs, 1,777 MBOs and 622 NCSs as on March 31, 2021, across more than 700 cities in the country.

MCFL is a 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 and garmenting to retailing. Other major Group companies include Oswal Woollen Mills Ltd., Nahar Industrial Enterprises Ltd. and Nahar Spinning Mills Ltd.

MCFL was incorporated in July 2008 as a wholly-owned subsidiary of Oswal Woollen Mills Limited (OWML). Pursuant to the scheme of arrangement and demerger with OWML, the apparel business of OWML, comprising manufacturing facilities, sales distribution network and ownership of the 'Monte Carlo' brand, were transferred to MCFL with effect from April 1, 2011. Thereafter, MCFL ceased to be a subsidiary of OWML. The 'Monte Carlo' brand was originally launched by OWML in 1984 as an exclusive woollen brand. Over the years, the product portfolio of the brand was diversified to include summer-wear as well. Further, the company has expanded its portfolio by launching brands such as Denim, Alpha, Rock-it, and Cloak & Decker.

Key financial indicators (audited)

MCFL	FY2020	FY2021
Operating Income (Rs. crore)	725.6	622.0
PAT (Rs. crore)	62.7	66.3
OPBDIT/OI (%)	17.1%	18.6%
PAT/OI (%)	8.6%	10.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.5
Total Debt/OPBDIT (times)	0.9	1.0
Interest Coverage (times)	7.3	8.6

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 (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Aug 20, 2021	Aug 21, 2020	Sep 23, 2019	Nov 12, 2018	May 17, 2018
1	Cash Credit	Long-term	125.00	--	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Term Loan	Long-term	20.34	16.3	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
3	Unallocated	Long-term	24.66	--	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
4	Letter of Credit	Short-term	30.00	--	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Bank Guarantee^	Long-term/ Short-term	(10.00)	--	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
6	Commercial Paper	Short-term	100.00	25.00*	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Overdraft	Short-term	--	--	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

*^sub-limit of letter of credit; *as on August 16, 2021*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Long-term Fund-Based – Term Loan	Simple
Long-term Unallocated	Not applicable
Short-term Non-fund based (Letter of Credit)	Very Simple
Long-term/ Short-term Interchangeable (Bank Guarantee)	Very Simple
Commercial Paper	Very Simple

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	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	125.00	[ICRA]AA-(Stable)
NA	Term Loan	FY2015	NA	FY2026	20.34	[ICRA]AA-(Stable)
NA	Unallocated	NA	NA	NA	24.66	[ICRA]AA-(Stable)
NA	Letter of Credit	NA	NA	NA	30.00	[ICRA]A1+
NA	Bank Guarantee^	NA	NA	NA	(10.00)	[ICRA]AA-(Stable)/ [ICRA]A1+
INE950M14289	Commercial Paper	NA	NA	Sep 28, 2021	100.00	[ICRA]A1+

Source: *Company; ^sub-limit of letter of credit*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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