June 29, 2017

S. P. Apparels Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Long-term: Term Loan Facilities	14.76	[ICRA]A (Stable); upgraded from [ICRA]BBB+(Stable)
Long-term: Fund-based Facilities	20.0	[ICRA]A (Stable); upgraded from [ICRA]BBB+(Stable)
Short-term: Fund-based Facilities	115.0	[ICRA]A1; upgraded from [ICRA]A2
Short-term: Fund-based Facilities (Sub-limit)	(20.00)	[ICRA]A1; upgraded from [ICRA]A2
Long-term /Short-term: Unallocated	33.54	[ICRA]A(Stable)/[ICRA]A1; upgraded from [ICRA]BBB+(Stable)/[ICRA]A2

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating outstanding on the Rs.14.76-crore term loans and the Rs. 20.0-crore fund-based facilities of SP Apparels Limited (SPAL/the company) from [ICRA]BBB+ (pronounced ICRA triple B plus) to [ICRA]A (pronounced ICRA A)[1]. The outlook on the long-term rating is stable. ICRA has also upgraded the short-term rating outstanding on the Rs. 115.0-crore fund-based facilities and the Rs 20.00-crore fund-based sub-limits of SPAL from [ICRA]A2 (pronounced ICRA two) to [ICRA]A1 (pronounced ICRA A one). This apart, ICRA has upgraded the long-term/short-term rating outstanding on the Rs. 33.54-crore unallocated facilities of the company from [ICRA]BBB+(Stable)/[ICRA]A2 to [ICRA]A(Stable)/[ICRA]A1.

Rationale

The rating upgrades reflect the consistent improvement in the company's operational and financial performance during FY2017, which is evidenced by its stable volume and revenue growth, healthy margins as well as improved capitalisation levels and liquidity position. The company's established market position in the export of children's garments (knit-wear, which accounts for the bulk of its revenues) as well as its strong relationship with a reputed clientele (which has been aiding recurring order inflow) have been the key performance drivers. In addition, the operational strengths of SPAL include its fairly integrated nature of operations with presence across the garment value chain which supports operating efficiency and its strong manufacturing capabilities - with abilities to meet the stringent quality requirements, diverse product requirements with varying batch sizes and strict quality control setup with in-house accredited testing laboratories. The operational efficiency is expected to improve further, supported by the increasing backward integration initiatives including addition of spindle capacity, setting up of a knitting unit and modernization of its dyeing facility among others. The rating also considers the more-than-three-decade long experience of the promoters in the textile industry and the relatively less competition in the niche infant and children's wear export market owing to the stringent quality and complex manufacturing capability requirements.

[1] For complete rating scale and definitions, refer ICRA's website (www.icra.in) or other ICRA rating publications.

The healthy growth in earnings from operations, together with the fund infusion made through the initial public offering (IPO) during the last fiscal, has supported the improvement in the company's capitalisation levels and liquidity position. The proceeds from the IPO have been primarily utilised for reducing debt and capacity expansion to meet the increasing requirements of the existing and new customers. Most of the expansion is to be completed by the end of FY2018. With the funding requirements for incremental working capital and capacity expansion to be met with existing cash reserves and expected steady accruals, SPAL's leverage indicators are likely to improve going forward. The rating continues to factor in the company's high customer concentration, with its top three customers contributing to more than 85% of export revenues, also translating into relatively high geographic revenue concentration from the United Kingdom/European market. The company is also exposed to external factors, such as foreign exchange fluctuations, regulations and duty structures across markets. Furthermore, the ratings consider the increasing pricing pressure (on the back of appreciation in the Indian rupee) that exposes earnings to fluctuations in input prices, modest performance in the domestic retail segment due to competition, and demonetisation of high-value currency during the last fiscal and the moderately high working capital intensity inherent in the business. The company's ability to grow its retail business profitably, sustain profit margins in garment exports, diversify its client concentrations risks and optimise its working capital cycle will be the key rating sensitivities, going forward.

Key rating drivers

Credit strengths

- Improved operational and financial performance during FY2017, driven primarily by established relationship with reputed customers and equity infusion through IPO
- Healthy market position in the children's wear export segment, which enjoys relatively limited competition on account of stringent quality and complex manufacturing requirements, supports consistent revenue and earnings growth
- Fairly integrated operations with presence across the value chain aids operational efficiencies; improving backward integration measures with expansion of spinning and addition of knitting facilities to further enhance operational efficiency and support margins
- Comfortable financial profile, characterized by conservative capital structure with adequate coverage metrics and stable liquidity position lending financial flexibility

Credit weaknesses

- High customer-concentration risk with the top three customers accounting for ~85% of export revenues; widening customer base with addition of new customers across geographies; strong relationship with the existing customers lends comfort
- Increasing pricing pressure due to the appreciation of the Indian rupee exposes earnings to fluctuations in input costs; effective hedging practices and raw material sourcing arrangements protects earnings to an extent
- Intense competition and high fixed costs impact revenue growth and profitability in the domestic retail business; segment likely to breakeven over the near to medium term, supported by improved scale on the back of expansion measures and cost reduction initiatives undertaken

Description of key rating drivers

Located closer to the textile hub of Tirupur (Tamil Nadu), SPAL is engaged in the production of 100% knitted ready-made garments (RMG). The company predominantly caters to children's wear segment in the export market and derives a major portion of its revenues from relatively high margin products (garments with embroidery and patterns which are made in-house). SPAL derived ~85% of its revenues from exports (including incentives) in FY2017 and the rest from domestic market. SPAL exports to leading retailers based in Europe and have long-standing relationships with customers. While its revenues are exposed to fairly high levels of customer concentration, the risk is mitigated to an extent by its long standing relationship with its reputed clientele, which is reflected in the repeat business generated over the years. SPAL is also in the process of improving customer diversification with addition of new customers from the US and European markets. The company has fairly integrated manufacturing facilities with presence across spinning, processing (dyeing), garmenting (sewing), printing, and embroidery. The company is in the process of further enhancing its backward process capacities and debottlenecking & modernization of existing capacities. In the domestic market, SPAL derives majority of its income from sale of knitted garments through its wholesale ('Essentials') / retail (exclusive and multi brand outlets) business segments, apart from small portion of revenues accrued from yarn sales and fabric processing for garment manufacturers. While the contribution from the domestic retail business is limited at present, the company has plans to scale-up over the medium term by expanding its distribution network and also tie up with other large format stores to expand volumes. The same coupled with cost reduction measures undertaken are likely to support breakeven in cash profits over the next 12 to 18 months, with SPAL incurring losses at the operating level till FY2017 impacted by lower than expected turnover and high marketing and fixed costs in the retail division.

Revenues of SPAL continued to record steady growth during FY2017, supported by the strong growth in volumes. Despite the drop in realization, a result of the product mix manufactured with the increase in supplies catering to the economy segment, healthy growth in volumes supplied to key customers aided revenue growth of the company. Operating margin has improved steadily during the last two fiscals, owing to scale economy benefits, improving operational efficiency and better pricing terms with its suppliers. While the recent appreciation witnessed in INR is expected to result in pricing pressure for exporters like SPAL, its improving backward integration, value addition in the business and effective hedging practices are likely to buffer the impact to an extent. Capitalization levels and liquidity position of SPAL have also improved in line with the growth in earnings and also the fund infusion made through IPO during FY2017. Gearing, Total Debt to OPBDITA[2] and interest coverage ratios have improved to 0.5 times, 1.5 times and 7.0 times respectively in FY2017 from levels of 2.6 times, 3.1 times and 3.6 times witnessed in FY2016. The working capital intensity levels remain moderately high, in line with the nature of business, owing to the credit period enjoyed by customers and a manufacturing lead time of three to four months on an average. The liquidity position and dependence on bank borrowings for incremental working capital requirements are expected to improve going forward, aided by the steady growth in earnings from operations.

Analytical approach

For arriving at the ratings, ICRA has applied its rating methodology as indicated below.

Links to applicable criteria
[Corporate Credit Rating Methodology]

[2] Operating profit before depreciation, interest, tax and amortization

About the company

Promoted as a partnership firm by Mr. P. Sundararajan in 1989 and incorporated in November 2005 as a public limited company, SPAL is now listed in both the Bombay Stock Exchange and the National Stock Exchange post the IPO in August 2016. The company is an integrated readymade-garment manufacturer of 100% cotton garments, primarily for the children's wear export market. SPAL's manufacturing facilities located in and around Coimbatore (knitting, processing, garmenting, and printing and embroidery facilities) and Salem (spinning facility) in Tamil Nadu. The exports are made to renowned brands/marketers in the European Union (EU), lending stability to operations. It entered the domestic retail market in FY2007 by acquiring a 70% equity stake in Crocodile Products Private Limited, the Indian arm of the Singapore-based Crocodile International Private Limited (which markets the menswear brand, Crocodile). SPAL manufactures and markets apparels under the Crocodile brand in the business to consumer segment (B2C). It also markets essentials to other corporate entities (primarily retailers) in the domestic market.

On consolidated basis, during FY2017, SPAL reported net profit of Rs. 62.2 crore on an operating income of Rs.652.2 crore as against net profit of Rs. 18.8 crore on an operating income of Rs. 537.1 crore during FY2016.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years

Table

S. No.	Name of Instrument	Current Rating (2017)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	FY2018	FY2017	FY2016	FY2015
				June 2017	Sep 2016	Aug 2015	Jan 2015
1	Term Loans	Long Term	14.76	[ICRA]A (Stable)	[ICRA]BBB+(Stable)	[ICRA]BB(Stable)	[ICRA]D
2	Cash Credit	Long Term	20.00	[ICRA]A (Stable)	[ICRA]BBB+(Stable)	[ICRA]BB(Stable)	[ICRA]D
3	Fund-based Limits	Short Term	115.00	[ICRA]A1	[ICRA]A2	[ICRA]A4	[ICRA]D
4	Fund Based (sub-limits)	Short Term	(20.00)	[ICRA]A1	[ICRA]A2	-	-
5	Unallocated	Long Term /Short Term	33.54	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]BBB+(Stable)/ [ICRA]A2	-	-

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. crore)	Current Rating and Outlook
Term Loan I	-	-	Sep 2019	1.86	[ICRA]A(Stable)
Term Loan II	-	-	Sep 2019	5.14	[ICRA]A(Stable)
Term Loan III	-	-	Mar 2023	6.58	[ICRA]A(Stable)
Term Loan IV	-	-	Dec 2020	1.18	[ICRA]A(Stable)
Cash Credit	-	-	-	20.00	[ICRA]A(Stable)
Fund-based Limits	-	-	-	115.00	[ICRA]A1
Fund Based (sub-limits)	-	-	-	(20.00)	[ICRA]A1
Proposed /Unallocated	-	-	-	33.54	[ICRA]A(Stable)/ [ICRA]A1

Source: SPAL

Contact Details

Analyst Contacts
Jayanta Roy
+033-7150 1120
jayanta@icraindia.com

Balaji M
+044-4596 4317
balaji.m@icraindia.com

Relationship Contact
Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit **www.icra.in**

ICRA

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai
Mr. L. Shivakumar
Mobile: +**91 9821086490**
Email: shivakumar@icraindia.com

3rd Floor, Electric Mansion
Appasaheb Marathe Marg, Prabhadevi
Mumbai—400025,
Board : +91-22-61796300; Fax: +91-22-24331390

Kolkata
Mr. Jayanta Roy
Mobile: **+91 9903394664**
Email: jayanta@icraindia.com

A-10 & 11, 3rd Floor, FMC Fortuna
234/3A, A.J.C. Bose Road
Kolkata—700020
Tel +91-33-22876617/8839 22800008/22831411,
Fax +91-33-22870728

Chennai
Mr. Jayanta Chatterjee
Mobile: +**91 9845022459**
Email: jayantac@icraindia.com

5th Floor, Karumuttu Centre
634 Anna Salai, Nandanam
Chennai—600035
Tel: +91-44-45964300; Fax: +91-44 24343663

Bangalore
Mr. Jayanta Chatterjee
Mobile: +**91 9845022459**
Email: jayantac@icraindia.com

'The Millenia'
Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2,
Murphy Road, Bangalore 560 008
Tel: +91-80-43326400; Fax: +91-80-43326409

Ahmedabad
Mr. L. Shivakumar
Mobile: +**91 9821086490**
Email: shivakumar@icraindia.com

907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585049, 26585494, 26584924; Fax:
+91-79-25569231

Pune
Mr. L. Shivakumar
Mobile: +**91 9821086490**
Email: shivakumar@icraindia.com

5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range
Hills Road, Shivajinagar,Pune-411 020
Tel: + 91-20-25561194-25560196; Fax: +91-20-
25561231

Hyderabad
Mr. Jayanta Chatterjee
Mobile: +**91 9845022459**
Email: jayantac@icraindia.com

4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj
Bhavan Road, Hyderabad—500083
Tel:- +91-40-40676500