S.P. Apparels Limited

July 06, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Term Loan Facilities	14.76	33.30	[ICRA]A+(Stable); upgraded from [ICRA]A(Stable)
Short-term: Fund-based Facilities	115.00	150.00	[ICRA]A1; reaffirmed
Short-term: Interchangeable	(20.00)	(20.00)	[ICRA]A1; reaffirmed
Long-term: Fund-based Facilities	20.00	0.00	-
Long-term/Short-term: Unallocated	33.54	0.00	-

Rating action

ICRA has upgraded the long-term rating outstanding on the Rs. 33.30-crore term loan facilities (increased from Rs. 14.76 crore) of S.P. Apparels Limited (SPAL) from [ICRA]A (pronounced ICRA A)[1] to [ICRA]A+ (pronounced ICRA A plus). The outlook on the long-term rating is stable. ICRA has re-affirmed the short-term rating outstanding on the Rs. 150.00-crore fund-based facilities (increased from Rs. 115.00 crore) and the Rs 20.00-crore fund-based sub-limits of SPAL at [ICRA]A1 (pronounced ICRA A one).

Rationale

The upgrade in long term rating reflects the consistent operational and financial performance of SPAL during FY2018, and the expected improvement in earnings and capitalisation ratios over the next twelve months. SPAL's established market position in the infant wear export segment, strong relationship with a reputed clientele aiding recurring order inflow and growing supplies to new customers had supported volume growth during recent quarters, buffering the impact of Brexit related concerns which dented volumes during H1 FY2018. Operating profitability and earnings also remained stable in FY2018, despite the change in export incentive regime (reduction in duty drawback and rebate on state levies) on shift to goods and service tax (GST) during the year. Margins were aided by a mix of improving operating efficiency, better economies of scale and growing value addition apart from availability of input tax credit under GST. With improving customer and geographical mix and healthy growth in orders received from existing customers as evidenced by the current orderbook position, volumes of SPAL are expected to register growth upwards of 10% during FY2019. Operating margins are also expected to remain at current healthy levels of ~18-19%, backed by better value addition with the expansion of spinning capacity to be completed by December 2018. The ratings also take comfort from the comfortable financial profile of SPAL, characterised by conservative capital structure, adequate coverage metrics and stable liquidity position. Despite the ongoing capital expenditure plans towards capacity expansion to the tune of Rs. 150-160 crore combined during FY2019 and FY2020 and high working capital requirements, key ratios including Total Debt to operating profits and Interest Coverage are likely to remain comfortable at around 1.6 times and 7.3 times respectively in FY2020.

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. Revenues from new customers added during FY2018 increased to more than 10%

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

of export turnover. With proposed addition of other large retailers during FY2019, concentration towards top three customers is expected to reduce to ~70% by FY2020. 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 that exposes earnings to fluctuations in input prices, modest performance in the domestic retail segment due to intense competition (segment recorded breakeven during FY2018), and the high working capital intensity inherent in the business. Despite these concerns, the operational strengths of SPAL including its integrated nature of operations with presence across the garment value chain and its established presence with strong manufacturing capabilities are likely to drive performance over the medium term.

Outlook: Stable

ICRA believes that SPAL will continue to benefit from its established presence, growing customer base and ongoing capacity additions as witnessed in the growth recorded during recent quarters. The outlook may be revised to Positive if revenues and earnings significantly exceed estimates and further strengthen the financial risk profile. The outlook may be revised to Negative if there is any sharp reduction in earnings, or if there is any major debt-funded expenditure which would result in deterioration in capital structure and coverage indicators.

Key rating drivers

Credit strengths

Established presence and strong customer base – SPAL is an established manufacturer and exporter of children's wear, featuring amongst the larger organized exporters in the category. The company predominantly caters to the infant wear segment and derives a major portion of its revenues from relatively high margin value added products. SPAL exports to leading retailers based in Europe (including majors like ASDA, Tesco and Primark) and enjoys long-standing relationships with its customers. Aided by the recurring order inflow from its key customers, its revenues have recorded compounded annual growth rate of 10% in the last five fiscals.

Integrated nature of operations– SPAL enjoys 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. These steps would aid SPAL in reducing its external dependence for materials, thus gaining better control over the quality of the final output and resulting in better efficiencies and margins.

Comfortable capitalization ratios and liquidity position – Steady earnings from operations in recent fiscals coupled with funds raised through Initial Public Offering in FY2017 have supported a strong financial profile for SPAL, despite the continuous capital expansion undertaken and high working capital intensity. The same is evidenced by key ratios including gearing, debt service coverage ratio and net cash accruals to total debt levels being at 0.5 times, 3.0 times and 31% respectively for FY2018. Liquidity profile also remains comfortable, supported by the cash and liquid investments held (Rs. 76 crore as on March 31, 2018) and proposed enhancement of working capital lines.

Credit weaknesses

Customer concentration risk remains high; offset to an extent by the widening client base – As discussed earlier**,** top three customers continue to contribute to more than 85% of export revenues. Thus, the revenues and earnings of SPAL are exposed to vagaries in performance of its key customers, apart from other external factors such as regulations and duty structures across markets. Over the years, the customer base of SPAL had been limited primarily owing to capacity constraints. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, reflected in the repeat business generated over the years. The recent addition of capacities has helped the company in adding new customers. The trading business undertaken by its subsidiary (based out of the United Kingdom) has also lent some diversity to the revenue / customer base, with sales from UK operations increasing to ~Rs. 35 crore in FY2018.

Earnings exposed to fluctuations in input prices – Operating profitability of SPAL is exposed to volatility in cotton and yarn prices, with relatively limited pricing flexibility enjoyed with large customers. Earnings have been protected to a large extent against fluctuations in exchange rates through the back of back hedging arrangement undertaken by SPAL, with more than 80% of the receivables hedged in stages upon order confirmation. Further, ability to report stable operating margins during the last three fiscals provides comfort, despite the recent reduction in export incentives and modest margins witnessed in the domestic retail segment.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for entities operating in the Apparel Industry

About the company:

Located close to the textile hub of Tirupur in Tamil Nadu, SPAL is engaged in the production of 100% knitted cotton ready-made garments. Promoted as a partnership firm by Mr. P. Sundararajan in 1989 and incorporated in November 2005 as a public limited company, SPAL was listed in both the Bombay Stock Exchange and the National Stock Exchange in August 2016. SPAL's manufacturing facilities are located in and around Tirupur (knitting, processing, garmenting, and printing and embroidery facilities) and Salem (spinning facility) in Tamil Nadu. 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 and also trades in essentials in the domestic market.

Key Financial Indicators (Consolidated)

Fiscal	**FY2017**	**FY2018**
	(Audited)	**(Audited)**
Operating Income (Rs. crore)	649.7	673.3
PAT (Rs. crore)	53.6	47.8
OPBDIT/ OI (%)	18.7%	18.4%
RoCE (%)	22.5%	15.0%
Total Debt/ TNW (times)	0.5	0.6
Total Debt/ OPBDIT (times)	1.5	1.8
Interest coverage (times)	5.4	6.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated	Amount Outstanding*	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					July 2018	June 2017	Sep 2016	Sep 2015
1	Term Loans	Long Term	33.30	12.76	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BB (Stable)
2	Fund-based Limits	Short Term	150.00	147.00	[ICRA]A1	[ICRA]A1	[ICRA]A2	[ICRA]A4
3	Fund Based (sub-limits)	Short Term	(20.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A2	-
4	Fund-based Limits	Long Term	-	-	-	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BB (Stable)
5	Unallocated	Long Term /Short Term	-	-	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]BBB+ (Stable)/ [ICRA]A2	-

**outstanding as on Mar 31, 2018*

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

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan I	FY2017	-	FY2023	9.34	[ICRA]A+ (Stable)
NA	Term Loan II	FY2019	-	FY2024	20.00	[ICRA]A+ (Stable)
NA	Term Loan III	FY2010	-	FY2020	3.96	[ICRA]A+ (Stable)
NA	Short term: Fund-based Limits	-	-	-	150.00	[ICRA]A1
NA	Fund Based (sub-limits)	-	-	-	(20.00)	[ICRA]A1

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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

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