Pearl Global Industries Limited

March 29, 2019

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based limits (Term Loans)	40.12	[ICRA]BBB (Stable); Assigned
Short-term fund-based working capital limits	179.50	[ICRA]A3+; Assigned
Short-term non-fund-based limits	145.50	[ICRA]A3+; Assigned
Long-term/ Short-term Unallocated Limits	1.88	[ICRA]BBB (Stable)/ [ICRA]A3+; Assigned
Total	**367.00**	

*Instrument details are provided in Annexure-1

Rationale

The assigned ratings favourably factor in the strong operational profile of Pearl Global Industries Limited (PGIL), characterised by a geographically diversified manufacturing base, extensive experience of its promoters spanning over three decades in the garments exports industry as well as the long-term relationships established with renowned international retailers over the years, which has been facilitating repeat business. The ratings also factor in the company's comfortable capital structure (as reflected in a consolidated gearing or Total Debt/ Tangible Net Worth ratio of 0.81 time as on March 31, 2018), backed by a strong net worth position. The aforesaid strengths are, however, partially offset by the company's modest operating profitability (margins of ~4-5%), which together with high working capital requirements of the business translate into subdued return and debt protection metrics. Further, the liquidity profile of PGIL remains moderate, with utilisation of fund-based limits averaging at more than ~85% in 9M FY2019 (at standalone level). The ratings also factor in the high geographic concentration of revenues with more than ~80% of revenues arising from US markets, high dependence on its top three customers and seasonality in revenues with Q4 and Q1 of every financial year accounting for ~55-60% of revenues. Besides, the company's earnings remain exposed to volatility in input prices, foreign exchange rates and/or changes in duty structure/ incentives for exporters.

While assigning the ratings, ICRA has taken a note of the healthy ramp up in company's scale of operations and profitability in the recent quarter, after a subdued performance in FY2018 and H1 FY2019 primarily owing to sub-optimal utilisation of the newly enhanced capacities in some of its manufacturing locations. Besides, transitory reduction in export incentives at the time of GST implementation, firm raw material prices and limited pricing flexibility owing to intense competition in the industry had also affected the company's profitability during the said periods. In ICRA's view, PGIL's ability to sustain growth in revenues and profitability will be critical to sustain its credit profile and will be a key rating sensitivity.

Outlook: Stable

ICRA expects PGIL to continue to benefit from its established presence in the readymade garment exports with its sizeable and geographically diversified capacities, and an established customer base. These are together expected to facilitate a healthy turnover growth as well as sustained improvement in operating margins. The outlook may be revised to Positive if the company records significantly better-than-expected growth in revenues along with improvement in profitability levels and efficient working capital management, resulting in materially better-than-expected debt coverage metrics and liquidity profile. The outlook may be revised to Negative if the company is unable to maintain the improvement trajectory, resulting in lower than estimated coverage indicators and a weaker liquidity position. Further, any major debt-funded expenditure resulting in deterioration in capital structure and debt coverage indicators may exert a downward pressure on the ratings.

Key rating drivers

Credit strengths

Established track record and longstanding relationships with leading global apparel retailers – PGIL's promoters, the Seth family, have more than three-decade-long experience in manufacturing and export of apparels. Over the years, the promoters have fostered relationships with leading global apparel retailers, establishing a strong and a diversified client base. The company also enjoys a preferred long-term vendor status with most leading global brands and has been getting repeat business from these clients on a sustained basis, which has facilitated a healthy growth in its scale of operations. This also reflects favourably on the company's track record and competitive positioning in the apparel sector.

Strong operational profile, with large and diversified production capacities and product offerings – Over the years, PGIL has established a geographically strong manufacturing base in leading global apparel export hubs of India, Bangladesh, Vietnam and Indonesia. Besides equipping the company with competitive advantages of these regions (low labour cost/ low tariffs/ duty-free access), manufacturing presence across geographies mitigates the risk of regulatory changes for the company. With presence in three of the top six leading apparel exporting nations, PGIL is well positioned to capture the growth opportunities available in the global apparel trade. More so, the company benefits from its large scale, presence across segments (men's, women's as well as children's wear) and established relationships with leading global brands/ retailers.

Comfortable capital structure - Despite the sizeable debt-funded capital expenditure undertaken by the company in the recent years towards enhancement in capacities as well as consolidation of existing capacities across locations, PGIL has a comfortable capital structure, backed by a strong net worth position. This is reflected in a consolidated gearing (Total Debt/ Tangible Net Worth) of 0.81 time as on March 31, 2018.

Credit challenges

Modest financial risk profile characterised by thin profitability margins, high working capital requirements and moderate debt-coverage metrics - PGIL's operating margins have remained modest and range-bound at ~4-5% in recent years, owing to sub-optimal utilisation of its installed capacities, sizeable share of outsourced operations, focus on relatively lower-end price segment (average realisations of ~$5-6 per piece) as well as intense competition in the garmenting export sector. The margins were further affected in FY2018 by slower ramp up of recently enhanced capacities across entities, amid delays in getting new capacities compliant with key buyers. For the capacity enhancement, the company had incurred a sizeable capex of ~Rs 90-100 crore in FY2017 and FY2018, which led to increase in debt levels. Lower profits, alongside an increase in debt levels constrained the coverage metrics as reflected in an interest coverage ratio of 1.77 times and a debt-service coverage ratio (excluding short-term debt) of ~1.66 times in FY2018 on a consolidated basis. Further, PGIL's domestic operations are working capital intensive, indicated by gross working capital cycle (debtors + inventory holding) of 125-130 days in FY2018, owing to the nature of the business, which entails a longer production cycle and high inventory holding requirements. This results in significant dependence on bills discounting facilities, besides other pre/ post-shipment credit as well as LC-backed borrowings for domestic procurements, which translates into a high cost of borrowing, and thus a modest interest cover. Nevertheless, the ramp-up witnessed in the company's operations in Q3 FY2019 and expected improvement trajectory are likely to translate into a gradual improvement in its debt coverage metrics, going forward.

Seasonality inherent in operations, with Q1 and Q4 together accounting for ~55-60% of revenues - Seasonality inherent in the company's revenues, with ~55-60% of revenues being reported in Q1 and Q4 every financial year, exposes the company to earnings and cash flow volatility during the year. However, largely stable sources of non-operating income support the cash profits and hence debt servicing ability during the year.

Vulnerability to volatility in raw material prices, demand trends in key export markets and exchange fluctuations - Similar to other apparel exporters, PGIL's profitability is vulnerable to volatility in raw material prices (mainly cotton), which have historically accounted for ~50-55% of the company's cost of goods sold, as well as variations in foreign exchange rates. The forex risk is, however, mitigated to a large extent by the company's stated hedging policy as per which near-term exposure (less than three months) is largely hedged. This is also corroborated from the company's range-bound profitability over the past few years. Nevertheless, in terms of end-destination, PGIL faces concentration risk with its sales, primarily concentrated in the US region, which accounts for ~80% of company's consolidated sales. This makes the company vulnerable to any adverse demand trends or developments that affect consumer spending and preferences in the US markets.

High client concentration risk: Even though the company enjoys a preferred long-term vendor status with several renowned global brands and deals with a fairly large set of customers, it derives ~60-65% of its sales (at standalone level) from the top three customers.

Limited bargaining power due to significant competition in garment exports business - The intense competition that PGIL faces, not only from other textile exporters from India, but also from other low-cost garment exporting countries, limits its bargaining power/ pricing ability, thereby constraining its margins.

Liquidity position

PGIL's liquidity profile remains moderate, as reflected in the fund-based working capital utilisation averaging at more than ~85% in 9M FY2019. However, liquidity continues to be supported by adequate cash and liquid investments held by the company (unencumbered consolidated balances of ~Rs. 93 crore as on March 31, 2018 and ~ Rs. 74 crore as on December 31, 2018). Going forward, ICRA expects an improvement in the company's cash profits. Together with moderate annual repayment obligations of ~Rs 25-26 crore, marginal capex plans over the near to medium term, and steps taken by the company for part refinancing of the short-term borrowings with long-term borrowings, are expected to support an improvement in the company's cash flow position and liquidity profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Indian Textiles Industry- Apparels
Parent/Group Support	Not applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated operational and financial profile of PGIL. Details of the subsidiaries consolidated are given in Annexure 2

About the company:

Established in 1989 by Mr. Deepak Seth, the PGIL Group manufactures readymade garments, across categories (knits/ wovens/ denims/ non-denims/ outerwear) and segments (men's wear, women's wear as well as children's wear). The company (along with its subsidiaries) has its manufacturing base in India (Gurugram, Chennai and Bangalore), Bangladesh, Vietnam and Indonesia, with a total capacity to manufacture ~45 million pieces of garments per annum. PGIL is an approved vendor of renowned international brands and retailers, e.g., GAP, Banana Republic, Ralph Lauren, Kohl's, Macy's, Ann Taylor, Next, etc. The company is listed on the Bombay Stock Exchange as well as the National Stock Exchange, with a market capitalisation of Rs. 380 crore (as on March 27, 2019).

Key financial indicators (audited) - Consolidated

	FY2017	FY2018
Operating Income (Rs. crore)	1,546.8	1,516.7
PAT (Rs. crore)	42.0	23.1
OPBDIT/OI (%)	5.3%	4.4%
RoCE (%)	13.3%	10.2%
Total Debt/TNW (times)	0.72	0.81
Total Debt/OPBDIT (times)	3.44	4.91
Interest coverage (times)	2.37	1.77

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in		
	Instrument	Type			March-19	FY2018	FY2017	FY2016
1	Fund-based limits (Term Loans)	LT	40.12	40.12	[ICRA]BBB (Stable)	-	-	-
2	Working capital fund-based limits	ST	179.50	--	[ICRA]A3+	-	-	-
3	Working capital non-fund-based limits	ST	145.50	--	[ICRA]A3+	-	-	-
4	Unallocated limits	LT/ST	1.88	--	[ICRA]BBB (Stable)/ [ICRA]A3+	-	-	-

LT= Long-term, ST=Short-term

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 / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Jun-2018	10.50%	FY2025	6.66	[ICRA]BBB (Stable)
NA	Term Loan 2	Dec-2017	9.80%	FY2024	21.77	[ICRA]BBB (Stable)
NA	Term Loan 2	Mar-2015	11.00%	FY2024	11.69	[ICRA]BBB (Stable)
NA	Packing Credit/ Post-shipment finance	Sep-2017	NA	NA	179.50	[ICRA]A3+
NA	Letter of Credit & Bank Guarantee	Sep-2017	NA	NA	145.50	[ICRA]A3+
NA	Unallocated bank facilities	NA	NA	NA	1.88	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Pearl Global Industries Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Norp Knit Industries Limited	99.99%	Full Consolidation
Pearl Apparel Fashions Limited	100.00%	Full Consolidation
Pixel Industries Limited	100.00%	Full Consolidation
Pearl Global Fareast Limited	100.00%	Full Consolidation
Pearl Global (HK) Limited	100.00%	Full Consolidation

Note: The consolidated financials of above-mentioned entities capture the financials of their respective subsidiaries, i.e. indirect/ step-subsidiaries of PGIL (not listed in the table above).

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

Nidhi Marwaha
+91 124 4545 337
nidhim@icraindia.com

Annu Mendiratta
+91 124 4545 887
annu.mendiratta@icraindia.com

RELATIONSHIP CONTACT

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

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@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.

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ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

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

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999