July 01, 2019

S.P. Apparels Limited: Ratings re-affirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loans	41.23	38.70	[ICRA]A+(Stable); re-affirmed
Long-term fund-based working capital facilities (sub-limits)	(10.00)	(10.00)	[ICRA]A+(Stable); re-affirmed
Short-term fund-based working capital facilities	180.00	192.50	[ICRA]A1; re-affirmed
Short-term fund-based working capital facilities (sub-limits)	(115.00)	(115.00)	[ICRA]A1; re-affirmed
Non-fund based working capital facilities	40.00	42.50	[ICRA]A1; re-affirmed
Unallocated facilities	16.07	3.60	[ICRA]A+(Stable)/ [ICRA]A1; re-affirmed
Total	**277.3**	**277.3**	

**Instrument details are provided in Annexure-1*

Rationale

The re-affirmation of the ratings reflects the steady operational and financial performance of S.P. Apparels Limited (SPAL) in FY2019, and the expected stable earnings and credit metrics over the medium term. The consistent operating performance was supported by SPAL's established market position in the infant wear export segment, strong relationship with a reputed clientele, aiding in recurring order inflow, and growing supplies to new customers. The said factors helped SPAL in recording a strong volume growth of around 20% in garment exports in FY2019. ICRA expects SPAL's revenues to grow by more than 10% in FY2020 and FY2021, driven by improving customer and geographical diversification and healthy growth in orders from the existing customers. SPAL's operating margins (OPM) witnessed some moderation in FY2019 owing to a marginal drop in operating efficiency with new facilities commencing operations, shift in product mix and continued modest earnings generated from the domestic retail segment. Nevertheless, it remained at comfortable levels and is expected to be at around 17%, supported by improving economies of scale, healthy value addition in the infant wear segment and benefits accrued from the recent backward integration.

The ratings also continue to take comfort from the conservative financial profile of SPAL, characterised by an adequate credit metrics and a comfortable liquidity position. Key ratios including total debt to operating profits and interest coverage are likely to improve to around 1.2 times and 10 times, respectively in FY2020. The same is despite the ongoing capital expenditure plans to the tune of around Rs. 80 crore towards capacity expansion in FY2020 and high working capital requirements in the business. The ratings also continue to factor in the company's high customer and geographical concentration risks (which had impacted SPAL's performance in H1 FY2018), with its top four customers contributing around 85% to the revenues. Nevertheless, revenues from new customers have increased in the recent quarters and with the proposed addition of other large retailers, concentration towards top four customers is expected to reduce to ~70% by FY2021. The company is also exposed to external factors, such as foreign exchange fluctuations, regulations and duty structures across the markets. Besides, the ratings consider the increasing pricing pressure that exposes earnings to fluctuations in input prices, continued moderate performance in the domestic retail segment due to intense competition and the high working capital intensity inherent in the business. SPAL's ability to sustain growth in revenues and earnings to support and further improve its capital structure and liquidity position would remain key rating sensitivities.

Outlook: Stable

ICRA believes that SPAL will continue to benefit from its established presence, growing customer base and ongoing capacity additions. 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 any major debt-funded expenditure result in deterioration in capital structure and credit metrics.

Key rating drivers

Credit strengths

Established market presence and strong customer base – SPAL is a leading manufacturer and exporter of childrenswear, featuring among the large organised exporters in the category. The company predominantly caters to the high-margin value-added infant wear segment and exports to the leading global retailers, with which it has established relationships.

Integrated nature of operations– SPAL's operations are integrated across the textile value chain from spinning to garmenting and further value additions including printing and embroidery. The company has recently expanded its backward process capacities and completed debottlenecking and modernising its existing capacities, which are expected to improve value addition and operating efficiency. These measures would also help SPAL to reduce its dependence on external parties for materials and would support its quality and margins.

Comfortable financial profile – Stable earnings from operations in the recent fiscals have continued to support SPAL's financial profile, despite continuous capacity expansion undertaken and moderately high working capital intensity. The same is evident from key ratios including gearing, total debt to operating profits and interest coverage ratio of 0.4 times, 1.6 times and 9.0 times, respectively for FY2019. Despite the proposed expenditure for FY2020, steady earnings and adequate cash reserves are expected to support the credit profile of SPAL.

Credit challenges

Customer concentration risk remains high; widening client base mitigates the risk to some extent– The company's top four customers contributed ~85% to its export revenues in FY2019. Thus, revenues and earnings of SPAL depend on the performance of its key customers, apart from other external factors such as regulations and duty structures across the markets. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, and the recent addition of new customers. The fact that two of the recently added customers have contributed around 20% to the revenues in FY2019 and the continued steps by SPAL to diversify its revenue base provide comfort.

Earnings exposed to fluctuations in input prices – The operating profitability of SPAL is exposed to volatility in cotton and yarn prices, as it has limited pricing flexibility with large customers. Earnings have been protected to a large extent against fluctuations in exchange rates through back-to-back hedging arrangement undertaken by SPAL, with more than 80% of the receivables hedged in stages upon order confirmation. While the operating margins fell by around 200 bps in FY2019 owing to reasons as discussed earlier, SPAL's ability to report comfortable operating margins during the recent fiscals despite reduction in export incentives and modest margins witnessed in the domestic retail segment lend comfort.

Liquidity position

SPAL's liquidity profile remains comfortable, supported by the steady earnings from operations, cash reserves held (Rs. 58 crore as on March 31, 2019) and adequate unutilised lines of credit. The average utilisation of its fund-based limits stood at around 80% in the twelve-month period ending March 2019 and is expected to reduce further in the coming quarters. Despite the proposed capital expenditure of around Rs. 150 crore during the period FY2020-FY2022, healthy earnings with expected cash accruals of more than Rs. 100 crore per annum, the cash reserves held, and low repayment obligations are likely to support SPAL's cash flows over the medium term.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities operating in the Apparel Industry
Parent/Group Support	NA
Consolidation	For arriving at the ratings, ICRA has considered the consolidated financial profile of SPAL. Details of the subsidiaries, consolidated, are given in Annexure 2

About the company:

Located close to the textile hub of Tirupur in Tamil Nadu, SPAL produces 100% knitted cotton readymade 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 on 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, printing and embroidery facilities) and Salem (spinning facility) in Tamil Nadu. It entered the domestic retail market in FY2007 and markets its apparels under the Crocodile brand and trades in essentials in the domestic market.

Key financial indicators (Consolidated)

Fiscal	FY2018	FY2019
Operating Income (Rs. crore)	673.3	826.4
PAT (Rs. crore)	47.8	71.7
OPBDIT/ OI (%)	18.4%	16.4%
RoCE (%)	15.0%	19.2%
Total Debt/ TNW (times)	0.6	0.4
Total Debt/ OPBDITA (times)	1.8	1.6
Interest coverage (times)	6.7	8.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating July 2019	Date & Rating in FY2019 Jan 2019	Date & Rating in FY2019 Jul 2018	Date & Rating in FY2018 Jun 2017	Date & Rating in FY2017 Sep 2016
1	Term Loans	Long Term	38.70	31.90*	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based (sub-limits)	Long Term	(10.00)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)
3	Fund-Based Limits	Short Term	192.50	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2
4	Fund-based (sub-limits)	Short Term	(115.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2
5	Non-fund based Limits	Short Term	42.50	-	[ICRA]A1	[ICRA]A1	-	-	-
6	Unallocated limits	LT/ST term	3.60	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1

**Outstanding as on May 31, 2019; Source: SPAL*

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 Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	April 2015	-	Dec 2020	0.90	[ICRA]A+(Stable)
NA	Term Loan 2	Feb 2017	-	March 2023	5.32	[ICRA]A+(Stable)
NA	Term Loan 3	Nov 2017	-	March 2023	2.58	[ICRA]A+(Stable)
NA	Term Loan 4	June 2018	-	March 2024	7.50	[ICRA]A+(Stable)
NA	Term Loan 5	June 2018	-	March 2024	12.50	[ICRA]A+(Stable)
NA	Term Loan 6	Oct 2018	-	Not availed	9.90	[ICRA]A+(Stable)
NA	Long-term fund-based (sub-limits)	-	-	-	(10.00)	[ICRA]A+(Stable)
NA	Short-term fund-based Limits	-	-	-	192.50	[ICRA]A1
NA	Short term fund-based (sub-limits)	-	-	-	(115.00)	[ICRA]A1
NA	Non-fund based Limits	-	-	-	42.50	[ICRA]A1
NA	Unallocated limits	-	-	-	3.60	[ICRA]A+(Stable)/[ICRA]A1

Source: SPAL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Crocodile Products Private Limited	70%	Full Consolidation
S.P. Apparels (UK) (P) Limited	100%	Full Consolidation

Source: SPAL

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About ICRA Limited:

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