ICRA

March 30, 2020

Pearl Global Industries Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based limits (Term Loans)	80.12	82.65	[ICRA]BBB (Stable); reaffirmed
Short-term fund-based working capital limits	179.50	165.00	[ICRA]A3+; reaffirmed
Short-term non-fund-based limits	145.50	80.00	[ICRA]A3+; reaffirmed
Long-term/ Short-term Unallocated Limits	1.88	--	
Total	**407.00**	**327.65**	

** Instrument details are provided in Annexure I*

Rationale

The rating reaffirmation factors 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 continue to factor in the company's comfortable capital structure (as reflected in a consolidated gearing or Total Debt/ Tangible Net Worth ratio of 0.80 time as on December 31, 2019), backed by a strong net worth position. The aforesaid strengths are, however, partially offset by the company's modest operating profitability (margins of ~5-6%), which together with high working capital requirements of the business, translate into subdued return and debt protection metrics. The ratings also factor in the high geographic concentration of revenues with more than ~80% of revenues arising from the 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.

While reaffirming the ratings, ICRA noted the ~6% YoY decline in PGIL's consolidated revenues in 9M FY2020, mainly owing to a churn in its customer base. While the company sustained its margins at previous year levels in 9M FY2020, profitability for the full year is likely to witness some moderation due to a downward revision in export incentives with retrospective effect, which would necessitate write-off of export incentive benefits booked earlier. Despite this, ICRA estimates the company's debt coverage metrics for FY2020 (E) to remain adequate with an interest cover of ~1.9 times and debt-service coverage ratio (DSCR) of ~1.4–1.5 times.

ICRA, however, notes that the rapid and widening spread of the coronavirus outbreak which is resulting in a deterioration in the global economic outlook, is expected to create severe stress across sectors, regions and markets. The apparel sector is expected to be one of the most significantly affected sectors, given its sensitivity to consumer demand and sentiment, as well as the labour-intensive nature of apparel manufacturing operations. Against this backdrop and given the extremely high level of uncertainty of the present situation, ICRA will continue to monitor the developments, and may reassess the credit profile, if warranted. In the near term, ICRA expects PGIL's liquidity position to be adequate to meet its fixed expenses as well as debt obligations, supported by some cushion in working capital limits as well as free cash and bank balances.

The Stable outlook reflects ICRA's expectation that PGIL's near-term liquidity will remain adequate to take care of fixed expenses as well as debt servicing requirements, despite operational disruptions being faced. Further, ICRA expects the company's operational strengths to facilitate an improvement in performance after the Covid-19 impact subsides. A prolonged impact of Covid-19, however, which creates a sustained pressure on the company's liquidity profile and exposes it to heightened operating and financial risks such as order cancellations, payment delays, bad debts and inventory obsolescence may warrant a review of the assigned rating. ICRA will continue to monitor the developments in this regard and its implications on the company's performance and credit profile.

Key rating drivers and their description

Credit strengths

Established track record and relationships with leading global apparel retailers – PGIL's promoters, the Seth family, have more than three-decade-long experience in manufacturing and exporting 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 them 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. Moreover, 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. Going forward, the company is undertaking capacity expansion in India as well as Bangladesh, which is expected to support its operational strengths in the medium term.

Comfortable capital structure - Despite the sizeable debt-funded capital expenditure (capex) undertaken by the company in recent years for enhancing its capacities as well as consolidating its 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 0.8 time as on December 31, 2019.

Credit challenges

Modest financial risk profile characterised by thin profitability, high working capital requirements and moderate debt-coverage metrics - PGIL's operating margins remained modest and range-bound at ~4-5% in the past few 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 its enhanced capacities across entities, amid delays in getting its new capacities compliant with key buyers. While the operating margins improved to ~6.4–6.7% in FY2019 and 9M FY2020, supported by improved operational efficiencies and expectations of higher export incentives, these remained modest. Further, profitability for the full year is likely to witness some moderation from 9M FY2020 levels due to a downward revision in export incentives with retrospective effect, which would necessitate write-off of export incentive benefits booked earlier. Besides, the debt levels continue to increase amid regular debt-funded capex towards capacity expansion and debottlenecking undertaken by the company across geographies. The company incurred a capex of ~Rs. 80 crore in FY2019 and ~Rs. 40-50 crore in FY2020(E). Modest profitability alongside an increase in debt levels continues to keep company's coverage metrics moderate as reflected in Debt/OPBDITA of ~3.8 times, an interest coverage (OPBDITA/ interest and finance charges) ratio of 2.2 times and a debt-service coverage ratio (excluding short-term debt) of ~1.8 times in 9M FY2020, on a consolidated basis. Further, PGIL's operations are working capital intensive, indicated by gross working capital cycle (debtors + inventory holding) of 105 days in FY2019, 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.

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 of 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 by 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 the 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 large set of customers, it derives ~60-65% of its sales (at standalone level) from its top three clients. This exposes the company to client concentration risk. The risk is heightened considering the long-drawn approval process prevalent in the sector to get an approved vendor status from a renowned buyer. This is corroborated by the decline witnessed in the company's revenues during FY2020(E) owing to loss of business from a large customer amid financial difficulties witnessed by the buyer/retailer.

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: Adequate

At a consolidated level, PGIL's liquidity profile remains adequate, with fund flow from operations expected to remain adequate against its debt repayment obligations, and margin funding for working capital. For meeting the planned capex outlay, the company has adequate debt-tie-up in place. Besides, the liquidity profile is supported by non-operating income (mainly interest income and rentals), as well as sizeable free cash balances across entities.

At a standalone level, there is limited headroom available in expected cash profits, against repayment obligations. However, the liquidity profile is supported by adequate cash and liquid balances (free balances of ~Rs 18.6 crore as on December 31, 2019), non-operating income from rentals as well as flexibility in limits in the form of interchangeability of non-fund-based and fund-based limits to the extent of Rs 30 crore.

Rating sensitivities

Positive triggers -The ratings may be considered for an upgrade if PGIL reports a higher than expected growth in revenues along with a sustained improvement in profitability levels and working capital cycle, resulting in better than expected return indicators, debt coverage metrics and liquidity profile. Specific credit metrics to include Debt/OPBDITA of less than 2.5 times, DSCR of more than 2.0 times and return on capital employed (ROCE) of more than 13% on a sustained basis.

Negative triggers – PGIL's inability to revert to an improving trajectory in terms of revenue growth and operating margins for a sustained period, or increased challenges such as stretch in working capital cycle and pressure on liquidity due to conditions internal or external (including the impact of Covid-19 across regions) may warrant a rating review. Lower than estimated capitalisation and coverage indicators and a weaker liquidity position could result in a downward pressure on the ratings. Specific credit metrics will include Debt/OPBDITA of more than 3.5 times and DSCR of less 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 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 consolidated subsidiaries are given in Annexure 2

About the company

Established in 1989 by Mr. Deepak Seth, PGIL (including its subsidiaries) 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's (along with its subsidiaries') manufacturing base lies across India (Gurugram, Chennai and Bangalore), Bangladesh, Vietnam and Indonesia, with a total manufacturing capacity of ~54 million pieces of garments per annum. PGIL is an approved vendor of renowned international brands and retailers, such as GAP, Banana Republic, Ralph Lauren, Kohl's, Macy's, Ann Taylor, and Next, among others.

Key financial indicators (audited)- Consolidated

	FY2018	FY2019	9M FY2020*
Operating Income (OI) (Rs. crore)	1,516.8	1,769.3	1,183.2
Profit after tax (PAT) (Rs. crore)	23.1	67.1	22.9
Operating profit before depreciation, interest and tax (OPBDIT)/OI (%)	4.5%	6.4%	6.8%
RoCE (%)	10.3%	16.5%	10.2%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.3	1.5
Total Debt/OPBDIT (times)	4.6	2.9	3.8
Interest Coverage (times)	1.8	2.7	2.2
DSCR	1.7	2.0	1.8

** 9M FY2020 financials are provisional*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018	FY2017
					30-Mar-2020	16-May-2019	29-Mar-2019	--	
1	Fund-based limits (Term Loans)	Long Term	82.65	71.62*	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	--	--
2	Working capital fund-based limits	Long Term	165.00		[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	--	--
3	Working capital non-fund-based limits	Short Term	80.00		[ICRA]A3+	[ICRA]A3+	[ICRA]A3+	--	--
4	Unallocated limits	Long Term	--		--	[ICRA]BBB (Stable)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+	--	--

Amount in Rs. crore
**outstanding as on December 31, 2019*

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	Mar-2017	9.05%	FY2025	5.60	[ICRA]BBB (Stable)
NA	Term Loan 2	Jul-2017	10.25%	FY2025	18.00	[ICRA]BBB (Stable)
NA	Term Loan 3	Apr-2015	10.10%	FY2024	8.80	[ICRA]BBB (Stable)
NA	Term Loan 4	Feb-2019	10.10%	FY2029	39.25	[ICRA]BBB (Stable)
NA	Term Loan 5	Nov-2019	9.25%	FY2026	11.00	[ICRA]BBB (Stable)
NA	Packing Credit/ Post-shipment finance	Apr-2019	NA	NA	165.00	[ICRA]A3+
NA	Letter of Credit & Bank Guarantee	Apr-2019	NA	NA	80.00	[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).

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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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