August 30, 2021 (Revised)

Pearl Global Industries Limited: Rating reaffirmed/ assigned to enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based limits (Term Loans)	82.65	100.94	[ICRA]BBB (Stable); reaffirmed/ assigned to enhanced limits
Short-term fund-based working capital limits	165.00	195.00	[ICRA]A3+; reaffirmed/assigned to enhanced limits
Short-term non-fund-based limits	80.00	160.00	[ICRA]A3+; reaffirmed/assigned to enhanced limits
Total	**327.65**	**455.94**	

**Instrument details are provided in Annexure-1*

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. The ratings note its long-term relationships with renowned international retailers, which has been facilitating repeat business. The ratings continue to factor in the company's comfortable capital structure, 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. Further, its profitability remains vulnerable to any adverse changes in the export incentive rates/ structure, volatility in raw material prices and exchange rate fluctuations. The ratings also factor in the high geographical concentration risk with more than ~80% of revenues arising from the US markets, high dependence on its top five customers and seasonality in revenues.

While reaffirming the ratings, ICRA has taken a note that the second wave of the pandemic resulted in operational disruptions for the company in Q1 FY2022, similar to the last year. However, these were temporary in nature and less severe compared to the previous year, with the operations back to normal now. Following the operational disruptions and demand pressures faced by the company in H1 FY2021, a healthy recovery in demand was seen in H2 FY2021, supported by increased consumer confidence, opening up of markets and pent-up demand. This helped PGIL to partially offset the steep decline reported in the initial months of the year and maintain a comfortable financial risk profile and liquidity position. ICRA expects a similar trend this year to help the company offset the impact seen in Q1 FY2022.

The Stable outlook reflects ICRA's expectation of a steady operational and financial risk profile, supported by improvement in demand for apparels from international markets, particularly USA, which together with expectation of uninterrupted operations across geographies incrementally should help the company ramp up utilisation of its enhanced capacities.

Key rating drivers and their description

Credit strengths

Established track record and longstanding relationships with leading global apparel retailers – PGIL's promoters, the Seth family, have more than three decades of 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 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 its 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 offering competitive advantages of these regions (low labour cost/ low tariffs/ duty-free access), its manufacturing presence across geographies mitigates the risk of regulatory changes for the company. Therefore, PGIL benefits from its large scale, presence across the garment 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 0.7 times as on March 31, 2021.

Credit challenges

Modest financial risk profile characterised by thin profitability, high working capital requirements and moderate debt coverage metrics – PGIL's operating margins have remained modest and range-bound at ~5-6% over 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. Modest profitability continues to keep the company's capitalisation and coverage metrics moderate as reflected in Debt/OPBDITA of ~4.6 times, interest coverage (OPBDITA/ interest and finance charges) ratio of 1.7 times and a debt service coverage ratio (excluding short-term debt) of ~1.3 times in FY2021, on a consolidated basis. Further, PGIL's operations are working capital-intensive by nature, indicated by gross working capital cycle (debtors + inventory holding) of 139 days in FY2021. This entails a longer production cycle and high inventory holding requirements. High reliance on fund-based as well as non-fund based working capital facilities results in high cost of borrowing, and thus a modest interest cover.

Seasonality inherent in operations – 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. In FY2021, due to the pandemic-led lockdown restrictions in Q1 FY2021, ~60% of the revenues were reported in H2 FY2021.

Vulnerability to volatile raw material prices, demand trends in key export markets, forex rates and changes in export incentive structure – 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 its 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 the 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, which are primarily concentrated in the US region (~80% of standalone sales). This makes the company's performance vulnerable to any adverse demand trends or developments that affect consumer spending and preferences in the US markets. Further, similar to other apparel exporters, high dependence on export incentives in Indian operations exposes its profitability and competitiveness in the international markets to any adverse change in the export incentive structure.

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 ~65-70%% of its sales (at standalone level) from the top five customers. 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. However, comfort can be derived from the strong profile of PGIL's customers and long association with these customers, along with an established track record of repeat orders.

Limited bargaining power due to significant competition in garment exports business – The intense competition from textile exporters based in India and other low-cost garment exporting countries limits PGIL's bargaining power/ pricing ability, thereby constraining its margins.

Liquidity position: Adequate

At the 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. 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 the standalone level as well, the liquidity position is adequate as reflected by cash and liquid balances (free balances of ~Rs. 37.5 crore as on June 30, 2021 and an average cushion of around Rs. 44 crore in working capital limits during the six months ending June 2021). Further, the liquidity is supported by 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 factors – The ratings may be upgraded if PGIL reports a sustained improvement in its profitability and working capital cycle, resulting in an improvement in its return indicators, debt coverage metrics and liquidity profile. Specific credit metrics that may trigger a rating upgrade include DSCR of more than 1.8 times on a sustained basis.

Negative factors – Sustained pressures on revenues and profitability, or a sizeable capex/ stretch in working capital cycle, which exerts a pressure on the company's debt coverage metrics and liquidity position, may trigger a downward rating revision.

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; the details of the subsidiaries (consolidated) 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 (along with its subsidiaries) has its manufacturing base in India (Gurugram, Chennai and Bangalore), Bangladesh, Vietnam and Indonesia, with a total capacity to manufacture ~74 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.

Key financial indicators (audited)

Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	1,685.1	1,490.9
PAT (Rs. crore)	21.7	17.5
OPBDIT/OI (%)	6.1%	5.3%
PAT/OI (%)	1.3%	1.2%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	1.4
Total Debt/OPBDIT (times)	3.7	4.6
Interest Coverage (times)	2.0	1.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Aug 26, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Aug 12, 2021 Aug 30, 2021	--	May 16, 2019 Mar 30, 2020	Mar 29, 2019
1	Fund-based limits (Term Loans)	Long Term	100.94	100.94	[ICRA]BBB (Stable)	--	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Working capital fund-based limits	Short Term	195.00	--	[ICRA]A3+	--	[ICRA]A3+	[ICRA]A3+
3	Working capital non-fund-based limits	Short Term	160.00	--	[ICRA]A3+	--	[ICRA]A3+	[ICRA]A3+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based limits (Term Loans)	Simple
Short-term fund-based working capital limits	Very simple
Short-term non-fund-based limits	Very simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/ Lender details	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Kotak Mahindra Bank Ltd	Long-term fund-based limits (Term Loans)	Mar 2017	7.65%	Dec 2024	4.49	[ICRA]BBB (Stable)
HDFC Bank	Long-term fund-based limits (Term Loans)	Jul 2017	7.50%-8.95%	Mar 2026	20.65	[ICRA]BBB (Stable)
Andhra Bank	Long-term fund-based limits (Term Loans)	Apr 2015	9.85%	Apr 2024	0.90	[ICRA]BBB (Stable)
IndusInd Bank	Long-term fund-based limits (Term Loans)	Feb 2019	7.85%-9.50%	Dec 2028	38.64	[ICRA]BBB (Stable)
Punjab National Bank	Long-term fund-based limits (Term Loans)	FY2021	8.10%	Sep 2022	5.16	[ICRA]BBB (Stable)
UCO Bank	Long-term fund-based limits (Term Loans)		7.40%	May 2022	1.47	[ICRA]BBB (Stable)
State Bank of India	Long-term fund-based limits (Term Loans)		7.50%	Feb 2026	20.95	[ICRA]BBB (Stable)
Standard Chartered Bank	Long-term fund-based limits (Term Loans)		7.95%	Feb 2026	4.88	[ICRA]BBB (Stable)
RBL Bank	Long-term fund-based limits (Term Loans)		7.80%	Mar 2026	3.80	[ICRA]BBB (Stable)
Punjab National Bank	Short-term fund-based working capital limits	NA	5.10%	NA	70.50	[ICRA]A3+
UCO Bank	Short-term fund-based working capital limits	NA	5.20%	NA	16.50	[ICRA]A3+
State Bank of India	Short-term fund-based working capital limits	NA	4.50%	NA	25.00	[ICRA]A3+
Standard Chartered Bank	Short-term fund-based working capital limits	NA	6.00%	NA	14.00	[ICRA]A3+
RBL Bank	Short-term fund-based working capital limits	NA	5.85%	NA	20.00	[ICRA]A3+
HDFC Bank	Short-term fund-based working capital limits	NA	5.75%	NA	12.00	[ICRA]A3+
Unallocated	Short-term fund-based working capital limits	NA	NA	NA	37.00	[ICRA]A3+
Punjab National Bank	Short-term non-fund-based limits	NA	NA	NA	36.50	[ICRA]A3+
Standard Chartered Bank	Short-term non-fund-based limits	NA	NA	NA	3.00	[ICRA]A3+
UCO Bank	Short-term non-fund-based limits	NA	NA	NA	13.00	[ICRA]A3+
State Bank of India	Short-term non-fund-based limits	NA	NA	NA	24.50	[ICRA]A3+
RBL Bank	Short-term non-fund-based limits	NA	NA	NA	7.00	[ICRA]A3+
Unallocated	Short-term non-fund-based limits	NA	NA	NA	76.00	[ICRA]A3+

Source: *PGIL*

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).

Corrigendum

Details of lenders have been updated in Annexure 1

ANALYST CONTACTS

Jayanta Roy
+91-33-71501100
jayanta@icraindia.com

Pavethra Ponniah
+91-44-45964314
pavethrap@icraindia.com

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

Geetika Mamtani
+91-124-4545832
geetika.mamtani@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

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches