July 29, 2024

S.P. Apparels Limited: Ratings reaffirmed and assigned for enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loans	8.49	0.49	[ICRA]AA- (Stable); reaffirmed
Short-term Fund-based – Working Capital Facilities	230.00	255.00	[ICRA]A1+; reaffirmed/ assigned for enhanced limits
Short-term – Non-fund Based	0.00	36.00	[ICRA]A1+; reaffirmed/ assigned for enhanced limits
Long-term / Short-term Unallocated Limits	38.81	3.01	[ICRA]AA- (Stable)/ [ICRA]A1+; reaffirmed
Total	**277.30**	**294.50**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmed ratings for S.P. Apparels Limited (SPAL) consider the expected improvement in the company's operational and financial performance in FY2025, following a flat revenue growth in FY2024 amid a challenging operating environment in the key end markets. The ratings remain supported by the company's strong operational profile marked by its established market position in the infantwear segment, established relationship with large customers in the UK market, integrated manufacturing set-up and vast experience of the promoters.

SPAL acquired Young Brand Apparel Private Limited (YBAPL) on June 21, 2024, for a total consideration of Rs. 167.0 crore, which was funded through its cash reserves. In addition, it bought a garments unit in Palladam (Tamil Nadu), along with land and buildings located at Perundurai (Tamil Nadu), from Bannari Amman Spinning Mills Limited (BASML) for Rs. 56 crore. SPAL intends to avail a term debt of Rs. 60 crore to make the final tranche payment in Q4 FY2025 for the acquisition of assets from BASML, subject to the fulfilment of conditions stipulated in the Memorandum of Undertaking. The acquisition will enable SPAL to scale up its revenues, expand into new product segments (inner wear) and widen its geographical presence in the US region, although it remains exposed to moderate stabilisation risks.

SPAL's revenue growth in FY2025 is expected to be driven by the improving demand scenario, backed by a healthy order book position and the contribution from YBAPL. The ratings also consider the favourable long-term demand prospects aided by the likely shift in procurement by large customers in US and the EU markets from China to markets like India.

The ratings also consider SPAL's strong financial profile, characterised by a conservative capital structure, healthy coverage metrics and expectation of steady operational and strong financial risk profiles in the medium term. Debt protection remained healthy in FY2024, backed by strong earnings with interest cover and net debt to operating profit at 8.5 times and 0.5 times, respectively, which is likely to remain comfortable post the availment of term debt of ~Rs. 60 crore in FY2025. Going forward, the company's business shall remain supported by the expected improvement in operating efficiencies, as well as business and geographical diversification after the acquisition of YBAPL.

The ratings, however, remain constrained by the vulnerability of the company's revenues and earnings to demand conditions in end-markets, any adverse change in export incentive's structure, high geographical and client concentration risks. The nature of the business makes the company's operations working capital intensive, driven by an extended inventory and receivable turnover period. Although revenue concentration remains, with the top three customers contributing ~66% of total revenues, recurring orders and established relationships with its customers provide some comfort. Along with the client concentration risk, high receivables expose the company to the counterparty credit risk. The ratings are also constrained by the intense competition in the industry, limiting the pricing flexibility of industry participants.

The Stable outlook on the long-term rating reflects ICRA's expectation that improvement in revenues and operating metrics of SPAL is likely to sustain. Further, the outlook underlines ICRA's expectation that the entity's incremental capex will be funded in a way that allows it to maintain its debt protection metrics commensurate with the ratings.

Key rating drivers and their description

Credit strengths

Established market presence and integrated nature of operations – SPAL is a leading manufacturer and exporter of childrenswear in India, with a track record of more than three decades. It is one of the largest organised exporters in the segment. The company predominantly caters to the high-margin value-added infant wear segment and exports to the leading global retailers with an established presence. SPAL's operations are integrated across the textile value chain from spinning to garmenting and further value additions through dying, printing and embroidery. The company has expanded its backward process capacities and completed the consolidation and modernisation of its existing capacities in recent years. Healthy demand, operational strengths and the recent acquisition of YBAPL are expected to support SPAL and lead to healthy revenue growth and a strong operating performance over the medium term.

Strong financial profile – SPAL's revenue growth was healthy in FY2023. However, in FY2024, it was flat due to weak demand in key export markets. Despite this, export volumes increased by 1% while realisations moderated due to reduction in raw material prices. The operating margin remained stable at 14.7% in FY2024 (against 14.8% in FY2023) despite an increase in freight and labour costs, which was offset by the decline in raw material prices. Nevertheless, a healthy revenue growth of ~34% is expected in FY2025, following the acquisition of YBAPL and a moderate increase in standalone volumes, supported by its healthy order book position. The company's capital structure and debt protection metrics continue to be strong, with interest cover at 8.5 times and net debt/ OPBDITA at 0.5 times in FY2024. The DSCR also stood comfortable at 5.5 times in FY2024. Although a marginal moderation is expected in debt coverage indicators with the availment of term debt of ~Rs. 60 crore in FY2025(to fund the acquisition of assets from BASML), it is expected to remain within comfortable levels.

Credit challenges

Customer concentration risk remains high and vulnerability of earnings to end-user demand conditions – SPAL's top three customers contributed ~65-70% of its revenues in FY2023 and FY2024, making the company's revenues vulnerable to the performance of these key customers and demand trends in crucial markets. Nevertheless, the risk is mitigated to an extent by the established relationships with its clientele, which foster repeat orders, the strong market position of its customers in key end-user markets, and the expected customer diversification resulting from YBAPL's acquisition. While the acquisition of YBAPL would support SPAL in diversifying its product profile by diversifying into the innerwear segment and adding new customers in the US, the company still faces moderate stabilisation risks related to this recent acquisition. Besides, the company remains exposed to labour unrest and attrition risks, given the nature of operations within the apparel manufacturing industry.

Earnings exposure to fluctuations in input prices and foreign currency exchange rates – SPAL's earnings remain exposed to fluctuations in cotton and yarn prices and exchange rates on the back of limited pricing flexibility enjoyed with key customers. SPAL faces competition from other large textile exporters from India as well as from other low-cost garment exporting countries, limiting its ability to improve prices and margins to an extent. While order-backed procurement for the major portion of the stock held limits raw material price risk to an extent, earnings have been protected to a large extent against fluctuations in exchange rates through back-to-back hedging arrangements undertaken by SPAL with around 80% of the receivables hedged in stages upon order confirmation from customers. Further, the company's operations are working capital intensive, driven by the elongated inventory as well as receivable turnover period. Additionally, it has client concentration risk, high receivable exposure to counterparty credit risk. Although some diversification is expected from the recently concluded YBAPL acquisition.

ESG Risks

Environmental risks: The sector remains exposed to the risks of elevated input costs owing to increased compliance expenses faced by suppliers amid tightening environmental regulations. The industry is exposed to environmental risks, primarily for water, land use and the impact of climate on production as well as post-consumer waste. While these risks have not resulted in material implications so far, policy actions for waste management, such as recycling textiles, could have cost implications for the companies. Any disruption in measures taken for appropriate treatment of wastewater/effluents could result in significant penalties while also causing a prolonged adverse impact on operations if authorities take any strict action.

Social risks: Being a labour-intensive segment, the entities operating in the garment sector are exposed to the risks of disruptions from inadequate human capital management, including safety and overall well-being. Besides, human rights issues and the inability to ensure diversity while providing equal opportunity could pose social risks for the company. Further, any significant increase in wage rates may affect the cost structure of apparel manufacturers, impacting the margins. A shortage of skilled workers could also affect operations/growth plans and remains a key concern. Measures implemented by the company towards employee welfare have not impacted the company's performance till date. Further, garment manufacturers are exposed to risks of conflicts with local communities. Entities are also exposed to major shifts in consumer preferences or developments, affecting discretionary consumer spending.

Liquidity position: Strong

SPAL's liquidity position on a standalone basis is expected to be strong over the medium term with expected healthy cash flow from operations, supported by a cash buffer of Rs. 110.4 crore and undrawn working capital limits of Rs. 128.6 crore as on March 31, 2024. However, SPAL has paid Rs. 184.0 crore till June 2024 towards the aforesaid acquisition and intends to avail term debt of 60.0 crore towards making the balance consideration in Q4 FY2025. While free cash reserves are expected to moderate in the near term to fund the aforesaid acquisition, healthy cash flow generated from operations and the buffer available in its working capital limits act as a cushion supporting its liquidity. The entity has term debt repayment obligations of Rs. 15.0 crore in FY2025 and Rs. 21.8 crore in FY2026.

Rating sensitivities

Positive factors – SPAL's long-term rating may be upgraded if it achieves significant growth in revenue and earnings and its business profile becomes more diversified with new customer additions across geographies while maintaining comfortable debt protection metrics and liquidity position. A specific credit metric that may lead to ratings upgrade includes return on capital employed (RoCE) improving over 25% on a sustained basis.

Negative factors – Pressure on SPAL's ratings may emerge if there is sustained pressure on revenue and earnings, or if there is an elongation in its working capital cycle, which would adversely impact its debt protection metrics and liquidity position. A specific credit metric leading to ratings downgrade includes a debt-to-operating profit ratio remaining above 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Textiles - Apparels
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. Details of the subsidiaries have been given in Annexure-II.

About the company

Promoted as a partnership firm by Mr. P. Sundararajan in 1989 and incorporated as a public limited company in November 2005, SPAL was listed on both the Bombay Stock Exchange and the National Stock Exchange in August 2016. SPAL is primarily involved in the manufacturing and exporting of infantwear and childrenswear to apparel retailers based in the UK and other developed markets. SPAL has manufacturing facilities in and around Tirupur (knitting, processing, garmenting, printing, and embroidery facilities) and Salem (spinning facility) in Tamil Nadu. It commenced operations for the domestic retail market in FY2007. Its retail division was hived off into a subsidiary company, S.P. Retail Ventures Limited, which markets apparel under the Crocodile brand. In FY2024, it incorporated a subsidiary in Sri Lanka, S.P. Apparels (International) Private Limited, and acquired YBAPL on June 21, 2024.

Key financial indicators

SPAL Consolidated	FY2022	FY2023	FY2024
	Audited	Audited	Audited
Operating income	867.2	1,098.1	1077.1
PAT	85.5	82.3	89.6
OPBDIT/OI	18.4%	14.8%	14.7%
PAT/OI	9.9%	7.5%	8.3%
Total outside liabilities/Tangible net worth (times)	0.7	0.6	0.5
Total debt/OPBDIT (times)	1.5	1.5	1.3
Interest coverage (times)	13.6	8.7	8.5

Source: Company, ICRA Research; Amount in Rs. Crore

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 (FY2025)			Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				July 29, 2024	May 15, 2023	May 11, 2022	-
1	**Term loans**	Long term	0.49	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	-
2	**Fund-based working capital facilities**	Short term	255.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
3	**Non-fund Based Limits**	Short term	36.00	[ICRA]A1+	-	[ICRA]A1+	-
4	**Unallocated Limits**	Long term/ Short term	3.01	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term loan	Simple
Short -term – Fund-based working capital facilities	Simple
Short-term – Non-fund based	Very Simple
Unallocated limits	Not applicable

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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans	FY2017-FY2021	NA	FY2024-FY2026	0.49	[ICRA]AA-(Stable)
NA	Fund-based working capital facilities	NA	NA	NA	255.00	[ICRA]A1+
NA	Short-term – Non-fund based	NA	NA	NA	36.00	[ICRA]A1+
NA	Unallocated Limits	NA	NA	NA	3.01	[ICRA]AA-(Stable)/ [ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	SPAL Ownership	Consolidation Approach
S.P. Apparels Limited	100.00% (rated entity)	Full Consolidation
Crocodile Products Private Limited	70.00%	Full Consolidation
S.P. Apparels (UK) (P) Limited	100.00%	Full Consolidation
S.P. Retail Ventures Limited	100.00%	Full consolidation
S.P. Apparels (International) Private Limited	100.00%	Full consolidation
Young Brand Apparel Private Limited	100.00%	Full consolidation

Source: Company and SPAL consolidated financial statements for FY2024

Note: ICRA has taken a consolidated view of the parent (SPAL) and its subsidiaries while assigning the ratings.

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About ICRA Limited:

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