May 15, 2023

S.P. Apparels Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loans	52.73	8.49	[ICRA]AA- (Stable) reaffirmed
Short-term Fund-based – Working Capital Facilities	190.00	230.00	[ICRA]A1+ reaffirmed
Short-term – Non-fund Based	23.00	0.00	-
Long-term / Short-term Unallocated Limits	11.57	38.81	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed
Total	**277.30**	**277.30**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation factors in S.P. Apparels Limited's (SPAL) strong financial profile, characterised by a conservative capital structure, healthy coverage metrics and a strong liquidity position, and expectation of steady operational and financial risk profiles in the medium term. Despite the slowdown in demand from the key exporting nations due to inflationary pressure and recessionary concerns, the company is estimated to have reported a healthy revenue and earnings growth in FY2023. It is also noted that the company's presence in the niche segment of infantwear aided it to achieve healthy revenues as infantwear demand is relatively less affected. The company is estimated to have reported a healthy operating margin in FY2023 despite a moderation due to high raw material prices (cotton and cotton yarn) and losses reported by its subsidiary, S.P. Apparels UK (P) Limited. This is estimated to have resulted in healthy absolute profits and cash accruals. The ratings also positively factor in the company's established market position and strong relationship enjoyed with large international customers, which is expected to aid the company in achieving healthy revenue growth in the medium term. Further, the debt protections metrics and liquidity position are expected to remain strong.

The ratings, however, remain constrained by the vulnerability of the company's profitability to any adverse change in the export incentives structure, along with high geographical as well as client concentration risks. Further, the company's operations are working capital intensive, driven by an elongated inventory as well as the receivable turnover period. Along with the client concentration risk, high receivables expose the company to the counterparty credit risk. Although there has been an improvement in the working capital intensity in FY2023, it continues to be high. Besides, the company is exposed to labour unrest and attrition risks, given the nature of the apparel manufacturing industry. The ratings are also constrained by the intense competition in the industry, which limits the pricing flexibility of industry participants.

The Stable outlook reflects ICRA's expectation that SPAL's operational and financial performances will continue to benefit from its established presence in the industry, long relationship with its key customers aiding in repeat orders, ongoing measures towards new customer additions, improving operating efficiencies and comfortable capitalisation levels.

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. It is one of the largest organised exporters in the category. The company predominantly caters to the high-margin value-added infantwear segment and exports to the leading global retailers, with which it has established relationships. SPAL's operations are integrated across the textile value chain from spinning to garmenting and further value additions including dying, printing, and embroidery. The company has expanded its backward process capacities and completed consolidation and modernisation of its existing capacities in the recent years. Healthy demand coupled with these operational strengths helped SPAL in registering a healthy growth in revenues in the last two fiscal years, and the operating performance is expected to remain strong over the medium term.

Strong financial profile – Post the pandemic-induced business disruptions in FY2021, the company has been able to scale up its operations at a healthy pace in FY2022, reporting a YoY revenue growth of ~33%, along with an improvement in the operating margin. With healthy demand for infantwear and strong order flow, the company is estimated to have registered a healthy revenue growth of ~35% in FY2023 as well. Despite a moderation in the operating margin in FY2023 due to high raw material prices (cotton and cotton yarn) and losses reported by its subsidiary, S.P. Apparels UK (P) Limited, it is estimated to have remained healthy at ~15%. The company's capital structure and debt protection metrics continue to be strong, supported by healthy profitability, despite some estimated moderation in FY2023. The interest cover is estimated to have moderated to ~9 times in FY2023 from 13.5 times in FY2022. The DSCR also stood comfortable at 3.1 times in FY2022. The liquidity position also remains strong, as indicated by cash and cash equivalents including the buffer in the sanctioned working capital limits of ~Rs. 173 crore as on February 28, 2023. With stable demand conditions and strong order book position, the company is expected to report a moderate revenues growth of ~10% in FY2024 along with an improvement in the profit margins. This should also result in an improvement in debt protection metrics for the company in FY2024.

Credit challenges

Customer concentration risk remains high with moderate labour risks – SPAL's top three customers contributed 85-90% to its revenues in FY2022 and 9M FY2023. The same exposes its revenues to the performance of its key customers, as seen in the past. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, aiding in repeat orders and strong market position of its customers in key end-user markets. Besides, the company is exposed to labour unrest and attrition risks, given the nature of the apparel manufacturing industry. The company's revenues and profitability are also exposed to any demand side risks. Despite the slowdown in demand from the key exporting nations due to inflationary pressure and recessionary concerns, the company is estimated to have reported a healthy revenue and earnings growth in FY2023. It is also noted that the company's presence in the niche segment of infantwear aided it to achieve healthy revenues as infantwear demand is relatively less affected.

Earnings exposed 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, which limits 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 arrangement 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 the receivable turnover period. Together with client concentration risk, high receivables expose the company to the counterparty credit risk. Although there has been an improvement in the working capital intensity in FY2023, it continues to be high.

Liquidity position: Strong

SPAL's liquidity position is expected to be strong over the coming quarters, supported by the anticipated growth in earnings and adequate unutilised lines of credit. Free cash and bank balances and the buffer available in working capital limits together stood at around Rs. 173.3 crore as on February 28, 2023. The average working capital utilisation stood at around 60% during the last 12 months ended in February 2023. Against the expected capital expenditure requirements of around Rs. 40-50 crore in FY2024 and low debt repayment obligations of Rs. 11.5 crore, SPAL's cash flows are expected to be supported by cash profit generation of around Rs. 147 crore, apart from the cash buffer enjoyed by the company.

Rating sensitivities

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

Negative factors – Pressure on SPAL's ratings may emerge if there is any sustained pressure on revenues and earnings, or if there is an elongation in its working capital cycle, which would adversely impact its debt protection metrics and liquidity position. Specific credit metric, which may result in ratings downgrade includes net debt-to-operating profit ratio remaining above 1.2 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Indian Textiles Industry – 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

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 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's manufacturing facilities are located in and around Tirupur (knitting, processing, garmenting, printing, and embroidery facilities) and Salem (spinning facility) in Tamil Nadu. SPAL is primarily involved in manufacturing and exports infantwear and childrenswear to apparel retailers based out of the UK and other developed markets. It entered the domestic retail market in FY2007. Its retail division was hived off into a subsidiary company, S.P. Retail Ventures Limited, which markets apparels under the Crocodile brand.

Key financial indicators

SPAL Consolidated	FY2021	FY2022	9M FY2023
	Audited	Audited	Provisional
Operating income	652.3	867.2	826.7
PAT	43.6	84.7	62.0
OPBDIT/OI	16.2%	18.4%	15.3%
PAT/OI	6.7%	9.8%	7.5%
Total outside liabilities/Tangible net worth (times)	0.6	0.7	-
Total debt/OPBDIT (times)	1.8	1.5	-
Interest coverage (times)	7.4	13.5	8.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Apr 30 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
					May 15, 2023	May 11, 2022	-	Mar 09, 2021	Apr 24, 2020
1	Term loans	Long term	8.49	8.49	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)
2	Fund-based working capital facilities	Short term	230.00	--	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1	[ICRA]A1
3	Non-fund Based Limits	Short term	0.00	--	-	[ICRA]A1+	-	[ICRA]A1	[ICRA]A1
4	Unallocated Limits	Long term/ Short term	38.81	--	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1
5	Fund-based Working Capital Facilities (Sublimits)	Long term	-	--	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)
6	Fund-based Working Capital Facilities (Sublimits)	Short term	-	--	-	-	-	[ICRA]A1	[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
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	8.49	[ICRA]AA-(Stable)
NA	Fund-based working capital facilities	NA	NA	NA	230.00	[ICRA]A1+
NA	Unallocated Limits	NA	NA	NA	38.81	[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

Source: SPAL annual report FY2022
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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