

May 23, 2023

Otto Clothing Private Limited: [ICRA]A(Stable); assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund-based Cash Credit	170.00	[ICRA]A(Stable); assigned
Long-term - Fund-based Term Loan	26.31	[ICRA]A(Stable); assigned
Total	196.31	

*Instrument details are provided in Annexure-1

Rationale

The assigned rating factors in the established presence of Otto Clothing Private Limited (OCPL) in the branded menswear segment in Tamil Nadu and strong distribution network comprising 2,000+ multi-brand outlets (MBOs) across South India and 64 exclusive brand outlets (EBOs), mostly based in Tamil Nadu. The rating factors in the extensive experience of the promoters of over three decades in the textile industry and expectation of need-based funding support from the Pothys Group¹ (rated [ICRA]A(Stable)). OCPL's revenues have witnessed a compounded annual growth rate (CAGR) of 15.6% during FY2018-FY2023, led by a healthy demand on account of its increasing distribution reach and improving brand presence. OCPL's debt coverage indicators remain healthy, aided by satisfactory profit margins, limited capital expenditure (capex) requirements and a controlled working capital cycle. ICRA expects the same to sustain, going forward, in the absence of any major debt-funded capex plans.

The rating is, however, constrained by the high working capital intensity of operations, emanating from high inventory and receivable days. The same is reflected in high net working capital vis-à-vis the operating income (NWC/OI) ratio in the range of 40-50%. OCPL remains exposed to the risk of geographical concentration as ~60-70% of its revenues is derived from Tamil Nadu. Further, OCPL remains dependent on the menswear category, which accounts for the major chunk of its revenues. Nevertheless, ICRA notes that OCPL's brands have a good brand recall and have been able to generate repeat sales. The company plans to diversify in new markets in North India and East India, going forward, and its ability to scale up operations in new geographies would be monitorable. OCPL's revenues and profitability are exposed to intense competition in the highly fragmented branded apparel industry.

The Stable outlook on OCPL's rating reflects ICRA's opinion that OCPL will generate steady cash flows, led by its established brand presence in South India (especially Tamil Nadu) and improving distribution reach. Given the absence of any major debt-funded capex plans, this would limit dependence on external debt, providing adequate support to its credit profile.

Key rating drivers and their description

Credit strengths

Established presence in domestic menswear segment – Operating for around two decades, OCPL's brands have a strong presence in the menswear segment in South India (especially in Tamil Nadu). The company has a strong distribution network comprising 2,000+ MBOs across South India and 64 EBOs, mostly based in Tamil Nadu. While the EBOs allow the company additional flexibility in promotion and brand building, enabling direct engagement with customers, the MBO channel helps OCPL expand its geographical presence with minimal investments. As OCPL derives 70-80% of the revenues through the MBO

¹ICRA has consolidated the business and financial profiles of Pothys Private Limited (PPL), Pothys Retail Private Limited (PRPL), Pothys Chennai (PC), Pothys Tirunelveli (PT) and Pothys Swarna Mahal Private Limited (PSPL) together referred to as the 'Pothys Group' given the significant operational and financial linkages among them and the common management.

route, it led to faster geographical reach and the same is reflected in its healthy revenue growth over the years. OCPL generates 10-15% of its revenues from Pothys retail showrooms.

Need-based funding support from Pothys Group and extensive experience of the promoters in the textile industry – OCPL benefits from the extensive experience of the promoters for over three decades in the textile industry. Apart from OCPL, the promoters are also present in retailing of apparel through the retail chain, Pothys. ICRA expects the Pothys Group to extend need-based financial support to OCPL. The Pothys Group has strong presence in South India, especially Tamil Nadu, where it enjoys a healthy market position in the apparel retail market and is the leading player in silk garments.

Healthy revenue growth in FY2022 and FY2023; improved credit metrics – Over the last six years, Otto's revenues have increased at a CAGR of 15.6%, led by healthy demand on account of its increasing reach and improving brand presence. Despite the pandemic-induced lockdown, OCPL reported revenues of Rs. 522 crore in FY2022, reflecting a YoY growth of 59%, largely led by volume growth. The growth trajectory continued in FY2023 with OCPL reporting revenues of Rs. 713 crore (as per provisional estimates), reflecting a YoY growth of 37%. The operating profit margins have moderated to 13.5% in 9M FY2023 (as per provisional estimates) from 15.2% in FY2022 due to lower gross margins on account of a change in the product mix in favour of less remunerative products. Nevertheless, aided by limited capex plans and controlled working capital cycle, the credit metrics have improved, as reflected in an interest cover of 6.6 times in 9M FY2023, as per provisional estimates (FY2022 – 4.8 times) and total debt-to-operating profit ratio of 2.1 times as on December 31, 2022, as per provisional estimates (FY2022 – 2.5 times). Over the years, as OCPL witnessed a healthy revenue growth and reinvested profits in the business, the gearing improved to 1.2 times as on December 31, 2022 (as per provisional estimates) from 2.6 times as on March 31, 2018. Going forward, ICRA expects the financial profile to remain comfortable in the absence of any major debt-funded capex plans.

Credit challenges

High working capital intensity of operations – OCPL's working capital intensity of operations, as reflected by the net working capital vis-à-vis the operating income (NWC/OI), has remained high in the range of 40-50% due to the need to maintain high inventory and offer high credit period to its customers (mainly MBOs). The inventory holding period remains high in the range of 140-150 days primarily due to the manufacturing nature of operations, consignment nature of sales (for some MBO customers) and need to stock garments in its own outlets. Large inventory holding translates into higher risk of obsolescence due to fast-changing fashion trends, which could necessitate higher discounting, impacting the margins. Going forward, the company's ability to manage its inventory and receivable levels, while targeting growth, will remain critical from the credit perspective. ICRA notes that the major portion of the inventory and the receivables are outstanding for less than 180 days each, which provides some comfort.

Exposure to high geographical and segmental concentration – OCPL's revenues are concentrated in South India with Tamil Nadu accounting for 60-70% of the revenues each fiscal. This exposes the company to the risks of geographical concentration and renders the revenue growth and profitability susceptible to market conditions in Tamil Nadu. Further, OCPL remains dependent on the menswear category, which accounts for the major chunk of its revenues. Nevertheless, ICRA notes that OCPL's brands have a deep presence in Tamil Nadu, which ensures strong brand recall and thereby repeat sales. The company plans to diversify to new markets in North India and East India, going forward, and its ability to scale up operations in new geographies would be monitorable.

Exposure to consumer spending trends and intense competition – The branded menswear segment is characterised by intense competition, with continuous expansion undertaken by several established/local brands across the regions. The same mandates continued high marketing spend for apparel retailers, limiting the operating margins of market players. OCPL's sales, profitability, and cash flows, like any other apparel players, are closely linked to macroeconomic conditions, consumer confidence and spending patterns, particularly considering the discretionary nature of its products. Besides, its sales remain vulnerable to the consumers' changing tastes and preferences, and competition from other large, branded players in the menswear segment.

Liquidity position: Adequate

OCPL's liquidity position is **adequate**, supported by increasing fund flow from operations that is largely deployed towards incremental working capital requirements. The company's average utilisation of working capital limits stood at around 91% in FY2023, reflecting an average cushion of around Rs. 15-20 crore with sufficient drawing power. The company availed enhancement in its working capital limits to Rs. 170 crore as on date from Rs. 141 crore in April 2022 to fund its growth trajectory. The company had availed Emergency Credit Line Guarantee Scheme (ECLGS) term loans in FY2022, which are repayable over five years, and the yearly term loan repayment obligation during FY2024-FY2026 stands in the range of Rs. 7-8 crore. The annual capex is expected to be Rs. 10-20 crore, largely towards capacity expansion (addition of sewing machines) along with furniture and fixtures towards opening new stores. The liquidity position is likely to remain adequate, going forward, given the steady cash generation in the business and absence of any major debt-funded capex plans. The liquidity profile of the company is boosted by need-based funding support from the Pothys Group.

Rating sensitivities

Positive factors – The rating may be upgraded if the company registers a sustained growth in its revenues and earnings, coupled with an improvement in the working capital cycle, which would strengthen its overall financial profile and the liquidity position.

Negative factors – Pressure on the rating may emerge if there is any sustained pressure on revenues and/or earnings or a deterioration in its working capital cycle, which would adversely impact its credit metrics and/or the liquidity position. The rating could be downgraded if the interest cover remains below 5.0 times on a sustained basis. Any weakening of support from the Pothys Group or a deterioration in its credit profile could be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Entities in The Indian Textiles Industry – Apparels Rating Approach - Consolidation Rating Approach - Implicit parent or group support
Parent/Group Support	Group – Pothys Group (rated [ICRA]A(Stable)) ICRA expects the Pothys Group to provide need-based funding support to OCPL
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of OCPL

About the company

Incorporated in 1996 as a partnership firm named Pothys Clothing Company, the entity was renamed and converted into Otto Clothing Private Limited in 2004. OCPL is involved in manufacturing and distribution of branded menswear including shirts, t-shirts and trousers under the brand names of 'Otto', 'Minister White' and 'Clarke Gable'. OCPL has two manufacturing units in Tamil Nadu with a total capacity of 8 million pieces per annum. The garments manufactured by OCPL are sold via its exclusive brand outlets and multi-brand outlets in South India.

Key financial indicators

Standalone	FY2021 (Audited)	FY2022 (Audited)
Operating Income (Rs. crore)	327.8	522.0
PAT (Rs. crore)	16.6	40.2
OPBDIT/OI (%)	14.9%	15.2%
PAT/OI (%)	5.1%	7.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.8
Total Debt/OPBDIT (times)	3.3	2.5
Interest Coverage (times)	2.7	4.8

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

Source: Company; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

Instrument	Type	Current Rating (FY2024)			Chronology of Rating History for the past 3 years		
		Amount Rated (Rs. Crore)	Amount Outstanding (Rs. Crore)	Date & Rating	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
				23-May-2023	-	-	-
1 Fund-based Cash Credit	LT	170.00	-	[ICRA]A(Stable)	-	-	-
2 Fund-based Term Loans	LT	26.31	25.49*	[ICRA]A(Stable)	-	-	-

LT – Long-term; *outstanding as on March 31, 2023

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long-term - Fund-based Cash Credit	Simple
Long-term - Fund-based Term Loan	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, are available on ICRA's website: [Click Here](#)

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	170.00	[ICRA]A(Stable)
NA	Term Loans	FY2021	8-9%	FY2026	26.31	[ICRA]A(Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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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.

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Branches



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