August 30, 2023

Pearl Global Industries Limited: Ratings upgraded; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based limits (Term Loans)	107.09	115.15	[ICRA]A- (Stable); upgraded from [ICRA]BBB+ (Stable) / assigned to enhanced limits
Short-term fund-based working capital facilities	210.85	210.00	[ICRA]A2+; upgraded from [ICRA]A2
Short-term non-fund-based limits	180.00	180.00	[ICRA]A2+; upgraded from [ICRA]A2
Total	**497.94**	**505.15**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings upgrade factors in the consistent healthy performance of Pearl Global Industries Limited (PGIL) over the last two years despite the evolving demand slowdown in its key market, the US, amid inflationary pressure which is affecting discretionary spending by the consumers. The ratings factor in the expectation of sustained comfortable revenue growth and return metrics over the medium term. ICRA expects the company to sustain a comfortable growth, led by its operational strengths, which provide it with a competitive edge, including long-term relationships with renowned international retailers, which have been facilitating repeat business. The experience of its promoters, spanning over three decades in the garments exports industry provides additional comfort. The impact of demand slowdown has also been partially offset for Indian exporters because of business re-route from China, amid concerns China's major cotton variety procured in Xinjian region (which is under human rights violation), and the China-plus- one policy proposed to be followed by the large buyers. It is pertinent to note that PGIL's geographically diversified manufacturing base across leading apparel-exporting regions of India, Bangladesh, Vietnam and Indonesia place it more favourably than its peers to benefit from the said potential shift, besides its large scale of operations and an established track record. Further, adoption of an asset-light model for expansion, going forward, is expected to reduce reliance on debt and keep PGIL's financial profile comfortable with healthy return metrics, a conservative capital structure and adequate coverage metrics.

The ratings, however, continue to be constrained by the vulnerability of PGIL's profitability to any adverse change 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 ~75% of the company's revenues derived from the US markets, high dependence on its top-five customers and seasonality in revenues. These apart, PGIL's operations are susceptible to intense competition, which limits the scope for bargaining power/ pricing ability.

The Stable outlook reflects ICRA's expectation of a sustained comfortable revenue growth, which together with improving utilisation of enhanced capacities and focus on asset-light expansion model, is likely to support a gradual improvement in PGIL's return, capitalisation and coverage metrics.

Key rating drivers and their description

Credit strengths

Established track record and long relationships with leading global apparel retailers – PGIL's promoters, the Seth family, has more than three decades of experience in manufacture and export of apparels. Over the years, the promoters have fostered relationships with leading global apparel retailers, establishing a strong and 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, 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. Further, in the current fiscal, PGIL has also diversified its manufacturing base in Guatemala, Central America through its subsidiary. As this is a near shore company, it would further aid in servicing US customers from Central America as the transit time would substantially reduce from here. Besides competitive advantages of these regions (low labour costs/ low tariffs/ duty-free access), its manufacturing presence across geographies mitigates the risk of country specific regulatory changes. 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 and improving financial risk profile – Despite the sizeable debt-funded capital expenditure (~Rs.460.9 crore in the last five years) undertaken by the company in the recent years towards enhancement in capacities and consolidation of the existing capacities across locations, PGIL has a comfortable capital structure, backed by a strong net worth position. This was reflected in a consolidated gearing (Total Debt/ Tangible Net Worth) of 0.8 times as on March 31, 2023, compared to 1.0 times as on March 31, 2022. Further, the coverage metrics improved in FY2023, reflected in the interest cover of 4.3 times and DSCR of 2.2 times against 3.0 times and 1.7 times, respectively in FY2022. Going forward, the company is expected to continue to report a gradual improvement in its financial risk profile on the back of healthy profit margin of 10-11% and reduced dependence on external debt with adoption of an asset-light model for expansion, thereby improving the interest cover ratio.

Credit challenges

Seasonality inherent in operations – The seasonality inherent in the company's revenues, with 55-60% of revenues reported in Q1 and Q4 of every financial year, exposes the company to earnings and cash flow volatility during the year. However, owing to demand slowdown in key exporting regions in Q4 FY2023, ~57% of FY2023 revenues was reported in H1 FY2023 itself. Going forward, the trend is expected to remain like the past years with 55-60% of revenues coming from Q1 and Q4 of every financial year.

Vulnerable to volatile raw material prices, demand trends in key export markets, forex rates and changes in export incentive structure – Like other apparel exporters, PGIL's profitability is vulnerable to the 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. Nevertheless, PGIL faces concentration risk with its sales, which are primarily concentrated in the US region (accounted for ~89% of standalone sales in FY2023). This makes the company's performance vulnerable to any adverse demand trend or development that affects consumer spending and preferences in the US markets. However, ICRA notes that PGIL has diversified its customer base to new geographies and in FY2023, ~8% of its revenue came from Japan. Further, like other apparel exporters, high dependence on export incentives in the 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 the standalone level) from the top-five customers. This exposes the company to client concentration risk. The risk is heightened with 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 associations with these customers, along with an established track record of repeat orders.

Limited bargaining power due to significant competition in garment exports business – Intense competition from other 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: Strong

At the consolidated level, PGIL's liquidity profile is strong, 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 the non-operating income (mainly interest income and rentals), as well as sizeable free cash balances across the entities (aggregating to ~Rs.276 crore as on March 31, 2023). PGIL has scheduled repayment obligations of Rs. 41.78 crore in FY2024, against projected net cash accrual of ~Rs.180 crore. ICRA also notes the fungibility of surplus cash flows across the entities through dividend payouts (from international subsidiaries to the domestic entity), unsecured loans, etc., which can help manage liquidity across various entities in the Group.

At the standalone level, the company's liquidity position is strong, reflected in the healthy free cash and liquid balances of ~Rs. 71 crore as on March 31, 2023 and a cushion in the fund-based working capital limits, which stood at ~47% of the sanctioned lines on an average during the last six months ending in June 2023 (equivalent to ~Rs.107 crore). Further, the liquidity is supported by the flexibility in the working capital limits in the form of interchangeability of non-fund-based and fund-based limits worth ~Rs. 247.5 crore out of total combined sanctioned limits of Rs. 390 crore.

Environmental and Social Risks

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

Being a labour-intensive segment, the entities operating in the garment sector are exposed to the risks of disruptions due to inability to properly manage human capital in terms of their safety and the overall well-being. Besides, human rights issues and 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. Shortage of skilled workers could also affect operations/growth plan and remains a key concern. Measures taken by the company towards employee welfare have resulted in no material impact on the performance from the above-mentioned risks till date. Further, garment manufacturers are also exposed to the risks of protests/conflicts with local communities. Entities also remain exposed to any major shift in consumer preferences or developments, affecting discretionary consumer spending in key markets.

Rating sensitivities

Positive factors – The ratings may be upgraded if PGIL reports a sustained improvement in its profitability and working capital cycle, resulting in better return indicators, debt coverage metrics and liquidity profile.

Negative factors – Sustained pressure on revenues and profitability, or a sizeable capex/stretch in the working capital cycle, which affects the company's debt coverage metrics and liquidity position, may trigger a downward rating action. A specific credit metric for ratings downgrade include an interest coverage below 4 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Textiles Industry – Apparels
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated operational and financial profiles of PGIL; the details of the subsidiaries (consolidated) are given in Annexure II

About the company

PGIL (including its subsidiaries), established in 1989 by Mr. Deepak Seth, manufactures readymade garments, across categories (knits/woven/denim/non-denim/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 Bengaluru), Bangladesh, Vietnam and Indonesia, with a total capacity to manufacture ~80 million pieces of garments per annum. PGIL is an approved vendor of renowned international brands and retailers like GAP, Banana Republic, PVH Corp., Kohl's, Macy's, Primark, Target, Next among others.

Key financial indicators

	FY2022	FY2023
Operating Income (Rs. crore)	2,737.2	3,167.8
PAT (Rs. crore)	70.1	153.0
OPBDIT/OI (%)	6.7%	11.1%
PAT/OI (%)	2.6%	4.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.4
Total Debt/OPBDIT (times)	3.5	1.6
Interest Coverage (times)	3.0	4.3

Source: PGIL

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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 Jun 30, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Aug 30, 2023	Aug 11, 2022	Aug 12, 2021 Aug 30, 2021	--
1	**Fund-based limits (Term Loans)**	Long-term	115.15	115.15	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB (Stable)**	--
2	**Fund-based working capital limits**	Short-term	210.00	--	**[ICRA]A2+**	**[ICRA]A2**	**[ICRA]A3+**	--
3	**Non-fund-based limits**	Short-term	180.00	--	**[ICRA]A2+**	**[ICRA]A2**	**[ICRA]A3+**	--

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long-term fund-based limits (Term Loans)	Simple
Short-term fund-based working capital facilities	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 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	Long-term fund-based limits (Term Loans)	Apr 2015	NA	Dec 2028	115.15	[ICRA]A- (Stable)
NA	Short-term fund-based working capital facilities	NA	NA	NA	210.00	[ICRA]A2+
NA	Short-term non-fund-based limits	NA	NA	NA	180.00	[ICRA]A2+

Source: *PGIL*

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

Annexure II: 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
Pearl Global Kausal Vikas Limited	100.00%	Full Consolidation
Pearl Global Fareast Limited	100.00%	Full Consolidation
Pearl Global (HK) Limited	100.00%	Full Consolidation
SBUYS E-Commerce Limited	100.00%	Full Consolidation
Pearl Global USA, Inc	100.00%	Full Consolidation
Sead Apparels Private 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:

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