August 21, 2020

Monte Carlo Fashions Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facility (cash credit)	75.0	125.0	[ICRA]AA-(Stable); reaffirmed
Long-term fund-based bank facility (term loan)	26.1	20.34	[ICRA]AA-(Stable); reaffirmed
Long-term unallocated	18.9	24.66	[ICRA]AA-(Stable); reaffirmed
Short-term non-fund based bank facility (Letter of Credit)	30.0	30.0	[ICRA]A1+; reaffirmed
Short-term fund-based bank facility (Overdraft)	50.0	0.0	-
Long-term/short-term interchangeable bank facility (Bank Guarantee)^	(10.0)	(10.0)	[ICRA]AA-(Stable)/ [ICRA]A1+; reaffirmed
Commercial Paper[1]	100.0	100.0	[ICRA]A1+; reaffirmed
Total	**300.00**	**300.00**	

**Instrument details are provided in Annexure-1; ^sub-limit of letter of credit*

Rationale

The ratings continue to derive strength from Monte Carlo Fashions Limited's (MCFL's or the company's) strong market position in the winter-wear segment with an established brand (Monte Carlo) and a multi-channel distribution network. Further, the ratings continue to be supported by MCFL's robust financial profile characterised by a strong capital base, negative net debt position during most part of the year and strong debt coverage indicators (total debt/operating profit before depreciation, interest, tax and amortisation (OPBDITA) of 0.9 time and interest coverage of 7.3 times for FY2020). Moreover, ICRA notes that MCFL benefits from the operational and financial flexibility as a part of the Ludhiana-based (Punjab) Nahar Group, which is one of the largest textile groups in the country with vertically integrated operations from spinning to garmenting.

These strengths are, however, partially offset by the company's exposure to trends in consumer spending. In this context, ICRA notes the prevailing tough operating environment for domestic apparel retailers owing to the Covid-19 pandemic. While on the one hand there have been operational disruptions due to the national as well as regional lockdowns, constraining MCFL's ability to sell, on the other hand discretionary consumer spending has been weak, affecting demand and resulting in severe performance pressures for the company, in line with the overall industry trend. Suboptimal sales, leading to under-absorption of fixed overheads, coupled with pressure on sales realisations due to aggressive discounting to push sales, is expected to result in a correction in the company's profit margins in FY2021.

[1] *The rating for the Rs. 100.0-crore commercial paper programme of MCFL is based on the condition that total borrowings by way of sanctioned working capital facilities from the banks and commercial paper will remain within a total of below mentioned* items:
(a.) lower of sanctioned working capital limits / maximum permissible banking finance; and
(b.) unencumbered cash balances / bank deposit / liquid mutual funds (investment such as equity, fixed maturity plans are excluded within the definition of liquid mutual fund).

Nevertheless, the impact is likely to be cushioned somewhat by the steps being taken by the company to control costs. Further, expectations of a recovery in sales from Q3 FY2021 onwards, supported by pent up demand as well as festive buying, augurs well for the company as the same coincides with its peak season (Q3 of a financial year typically accounts for ~56-57% of the company's annual sales). The ratings, however, continue to be constrained by the fragmented and competitive nature of the domestic apparel industry, which necessitates high marketing spends to maintain market presence. Despite MCFL's established position in the winter-wear segment, it faces intense competition in the summer-wear segment from several established brands operating in the country. In addition, the ratings are constrained by concentration risks arising from high dependence on the winter-wear segment under a single brand, which in turn drives seasonality in sales, limits geographical diversification, and makes sales vulnerable to weather conditions. The seasonality in business also results in high working capital requirements during the peak season (peak NWC/OI of ~70%) due to high levels of apparel inventory and credit sales to the distribution channel partners. Nonetheless, the company's reliance on the outright sale model for most of the sales with limited provision for sales returns partially mitigates the risk of obsolete inventory from unsold stock.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's expectation that a recovery in demand coinciding with the company's peak sales quarter would help it reduce the impact on full year sales and profitability, despite a challenging H1 FY2021. Coupled with a low dependence upon debt and a comfortable liquidity position, this is expected to support its strong credit profile.

Key rating drivers and their description

Credit strengths

Strong brand equity in the winter-wear segment and established distribution network – MCFL manufactures and retails winter and summer-wear apparel in the domestic market under its 'Monte Carlo' brand, which is an established brand, particularly in the winter-wear segment. The company has established a pan India, multi-channel distribution network, comprising 278 exclusive brand outlets (EBOs), over 2,500 multi-brand outlets (MBOs) and 566 large format stores/ national chain stores (NCSs) as on March 31, 2020, across more than 700 cities. The EBOs allow MCFL additional flexibility in promotion and brand building, enabling direct engagement with customers. The MBO channel, on the other hand, helps to expand its geographical reach with minimal investments.

Robust financial profile characterised by strong capital base, negative net debt position and strong debt coverage indicators, with comfortable liquidity profile – MCFL's dependence on external borrowings has remained low because of its strong capital base and healthy accruals, which have been sufficient to meet most of its funding requirements, as also reflected in its low leverage (total debt/tangible net worth, or TNW, of ~0.2 time as on March 31, 2020). Further, the company continues to maintain sizeable free cash and liquid investments (~Rs. 120 crore as on May 31, 2020), which are larger than the average borrowing level of the company during the year, resulting in negative net debt position during most months of the year. Low leverage coupled with limited debt repayments and healthy profitability results in strong debt metrics as reflected by total debt/OPBDITA of 0.9 time and interest coverage of 7.3 times for FY2020. This apart, MCFL has a comfortable liquidity profile, characterised by sizeable cash and liquid investment balances and adequate undrawn working capital limits during the year (average utilisation level of 15% vis-à-vis borrowing capacity[2] during the 6-month period ended May 2020 and 39% in the 15-month period ended May 2020). It is noted that the company witnesses an increase in working capital requirements during the third quarter of a financial year, in line with the trend in its sales, which results in increased utilisation of working capital borrowings (peak utilisation level of about 70% of the

[2] *Borrowing capacity here is defined as drawing power available to the company (i.e. lower of sanctioned working capital limits or estimated drawing power) + borrowings approved against company's fixed deposits and mutual fund investments*

borrowing capacity) during these months. Nonetheless, the company's drawing power typically remains much higher than the sanctioned fund-based working capital limits, which provides a flexibility to raise additional funds as and when required.

Operational and financial flexibility as part of the Nahar Group – MCFL is part of the Ludhiana-based Nahar Group, which is one of the largest and oldest textile groups in the country with vertically integrated operations from spinning and garmenting to retailing. The other companies in the Nahar Group include Oswal Woollen Mills Limited[3], Nahar Industrial Enterprises Limited[4], Nahar Spinning Mills Limited, Nahar Capital and Financial Services Limited[5], Nahar Poly Films Limited and Vanaik Spinning Mills Limited.

Credit challenges

High brand, segment and geographical concentration risks – MCFL has expanded its product as well as brand portfolio over the years to offer a complete range of winter and summer-wear. However, it continues to face high dependence upon the winter-wear segment under a single brand (Monte Carlo). Resultantly, MCFL's sales remain vulnerable to weather conditions, with more than ~50% of its revenues being generated in the third quarter of the financial year. Moreover, due to tropical climate in the western and southern regions, the winter-wear market is limited and consequently the company has limited presence in these regions, resulting in higher revenue concentration in northern, eastern and central regions.

High working capital intensity – MCFL's business is working capital intensive due to the high levels of apparel inventory and credit sales to its distribution channel partners. The apparel inventory level is high because of its need to stock apparels before the season to meet the requirement of its existing stores as well as new stores launched during the season. Further, the working capital requirements typically peak in the second and third quarters of the financial year with high inventory in the second quarter to meet higher third quarter sales and high receivables in the third quarter. Hence, the company's ability to minimise non-moving stock, stock returns and receivables from the previous season on a consistent basis will remain critical to control the working capital and keep the inventory write-down risk low. MCFL witnessed an increase in inventory in March 2020, due to inventory pile up following the imposition of lockdowns towards the end of the year, which resulted in an increase in working capital intensity by the end of FY2020.

Exposure to consumer spending trends and intense competition – MCFL's sales, profitability and cash accruals, like any other apparel retailers, are closely linked to macro-economic conditions, consumer confidence and spending patterns. This is being witnessed in the current financial year as well, with the company's revenues as well as profitability getting impacted by the pandemic. Besides, its sales remain vulnerable to the consumers' changing tastes and preferences, and the competition from branded as well as fragmented apparel manufacturers. The intense industry competition mandates high marketing spends to maintain market presence, particularly when there is a demand slowdown.

---

[3] *ICRA has rating outstanding of [ICRA]A-(Negative) and [ICRA]A2+ for Oswal Woollen Mills Limited*

[4] *ICRA has rating outstanding of [ICRA]BBB+(Negative) and [ICRA]A2 for Nahar Industrial Enterprises Limited*

[5] *ICRA has an [ICRA]A1+ rating outstanding for Nahar Capital and Financial Services Limited*

Liquidity position: Adequate

MCFL's liquidity position remains **adequate** with a comfortable cushion in sanctioned working capital limits (average undrawn limits of Rs. 223.7 crore vis-à-vis borrowing capacity in the three-month period ended May 2020) and sizeable free cash and liquid investments (~Rs. 120 crore as on May 31, 2020). Moreover, the company's demonstrated ability to generate healthy cash flow from operations (Rs. 46.4 crore in FY2020), together with nominal repayment obligations (Rs. 4.6 crore in FY2021) and no material expansion plans, is expected to help it maintain a comfortable liquidity profile. It is noted that the company witnesses increase in working capital requirements during the second and third quarters of a financial year, which results in increased utilisation of working capital limits/ borrowings (peak utilisation level ~70% of the borrowing capacity). As a result, MCFL's ability to maintain comfortable cash flows and liquidity during the peak season through an efficient working capital cycle and fund management remains crucial. Having said that, MCFL's drawing power typically remains much higher than the sanctioned fund-based working capital limits, which provides a flexibility to raise additional funds, in case of requirement.

Rating sensitivities

Positive triggers – The long-term rating could be upgraded if the company's scale of operations grows to the extent that its competitive position is enhanced. Further, increased diversification across brands, product segments (winter-wear/summer-wear) as well as regions, facilitating reduced seasonality in revenue as well as working capital requirements and supporting a sustained improvement in revenues and return metrics, could be a positive rating trigger.

Negative triggers – The ratings could be downgraded if there is a sustained pressure on the company's revenues and profitability as well as a decline in its return indicators. Additionally, MCFL's rating would be prone to a downgrade if it undertakes aggressive debt-funded investments/ acquisitions or experiences a significant stretch in its working capital cycle, which weakens its liquidity profile and/or results in an increase in its leverage. Specific metrics may include Total Debt/ OPBIDTA of more than 1.5 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	The ratings are based on the standalone financial profile of the company

About the company

MCFL is a Ludhiana-based manufacturer and retailer of apparels. The company retails its products under the 'Monte Carlo' brand, which is an established brand in the domestic apparel market, particularly in the winter-wear segment. MCFL had an established multi-channel distribution network of 278 EBOs, over 2,500 MBOs and 566 NCSs as on March 31, 2020, across more than 700 cities in the country.

MCFL is a part of the Ludhiana-based Nahar Group, which is one of the largest and oldest textile groups in the country with vertically integrated operations from spinning and garmenting to retailing. Other major Group companies include Oswal Woollen Mills Ltd., Nahar Industrial Enterprises Ltd. and Nahar Spinning Mills Ltd.

MCFL was incorporated in July 2008 as a wholly-owned subsidiary of Oswal Woollen Mills Limited (OWML). Pursuant to the scheme of arrangement and demerger with OWML, the apparel business of OWML, comprising manufacturing facilities, sales distribution network and ownership of the 'Monte Carlo' brand, were transferred to MCFL with effect from April 1, 2011. Thereafter, MCFL ceased to be a subsidiary of OWML. The 'Monte Carlo' brand was originally launched by OWML in 1984 as an exclusive woollen brand. Over the years, the product portfolio of the brand was diversified to include summer-wear as well. Further, the company has expanded its portfolio by launching brands such as Denim, Alpha, Rock-it, and Cloak & Decker.

In FY2020, the company reported a net profit of Rs. 62.7 crore on an operating income of Rs. 725.6 crore, compared to a net profit of Rs. 59.6 crore on an operating income of Rs. 656.4 crore in the previous year.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (OI) (Rs. crore)	656.4	725.6
PAT (Rs. crore)	59.6	62.7
OPBDIT/OI (%)	15.0%	17.1%
PAT/OI (%)	9.1%	8.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.7
Total Debt/OPBDIT (times)	0.5	0.9
Interest Coverage (times)	11.0	7.3

Source: Company's Annual Reports, ICRA research; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest and tax

Note: MCFL adopted IndAS 116 (on "Leases") with effect from FY2020 onwards, which increased reported operating profit, increased depreciation and interest charges, as well as increased reported debt owing to recognition of a lease liability reflecting future lease payments. As a result, FY2019 and FY2020 numbers captured in the table above are not comparable.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021) Type*	Amount Rated	Amount Outstanding #	Rating 21-Aug-20	Rating History for the Past 3 Years FY2020 23-Sep-2019	FY2019 12-Nov-2018	17-May-2018	FY2018 18-Oct-2017
1	Cash credit	LT	125.0	NA	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
2	Term loan	LT	20.34	20.34	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
3	Unallocated limits	LT	24.66	NA	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
4	Letter of Credit	ST	30.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Bank Guarantee^	LT/ ST	(10.0)	NA	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	-
6	Commercial Paper	ST	100.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Overdraft	ST	0.0	NA	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
8	Bank Guarantee	LT	-	-	-	-	-	-	[ICRA]AA-(Stable)

Amount in Rs. crore;
**LT: Long-term; ST: Short-term*
 # As on August 11, 2020
^sub-limit of letter of credit

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash credit	NA	NA	NA	125.0	[ICRA]AA- (Stable)
NA	Term Loan	FY2015	NA	FY2026	20.34	[ICRA]AA- (Stable)
NA	Unallocated limits	NA	NA	NA	24.66	[ICRA]AA- (Stable)
NA	Letter of Credit	NA	NA	NA	30.0	[ICRA]A1+
NA	Bank Guarantee^	NA	NA	NA	(10.0)	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Commercial Paper	NA	NA	7 to 365 days	100.0	[ICRA]A1+

^sub-limit of letter of credit
Source: Monte Carlo Fashions Limited

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

Analyst Contacts

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

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

Pratika Bhandari
+91 124 4545 321
pratika.bhandari@icraindia.com

Relationship Contact

L. Shivakumar
+91 22 6114 3406
shivakumar@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

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

© Copyright, 2020 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents