May 11, 2022

S.P. Apparels Limited: Ratings upgraded to [ICRA]AA-(Stable)/[ICRA]A1+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based Term Loans	36.26	52.73	[ICRA]AA-(Stable); Upgraded from [ICRA]A+(Stable)
Long-term – Fund-based Working Capital Facilities (Sublimits)	(2.00)	-	-
Short-term – Fund-based Working Capital Facilities	201.00	190.00	[ICRA]A1+; Upgraded from [ICRA]A1
Short-term – Fund-based Working Capital Facilities (Sublimits)	(115.00)	-	-
Short-term – Non-fund Based	40.00	23.00	[ICRA]A1+; Upgraded from [ICRA]A1
Long-term / Short-term Unallocated Limits	0.04	11.57	[ICRA]AA-(Stable)/[ICRA]A1+; Upgraded from [ICRA]A+(Stable)/[ICRA]A1
Total	**277.30**	**277.30**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings upgrade reflects better-than-expected performance of S.P. Apparels Limited (SPAL) in the recent quarters, and the likely steady revenues and earnings growth over the medium term, supported by its established market position in the infantwear segment and strong relationship with large customers in the UK market. The ratings continue to derive comfort from the strong financial profile, characterised by a conservative capital structure, healthy coverage metrics and a comfortable liquidity position. Post the decline in SPAL's revenues and earnings in FY2021 owing to demand disruption and labour issues, the operating performance recovered in FY2022, driven by strong growth in orders from key customers. Despite some moderation in Q1 FY2022 because of the second wave of the pandemic, SPAL's revenues and operating profits are estimated to have grown by around 30% each in FY2022 (albeit on a low base). The operating performance is expected to remain strong in FY2023, driven by the consistent growth in order inflows from existing large customers, addition of new customers and healthy margins enjoyed in the business. SPAL's performance remains supported by its established market position in the infantwear segment and strong relationship with large customers, and its improving operating efficiencies backed by an integrated manufacturing setup, driving healthy profitability in the garment business. These strengths are likely to support its performance in the coming quarters, though there could be some moderation in performance in the near term given the sharp increase in raw material costs and the inflationary pressure witnessed in the key end-user markets. ICRA expects SPAL to register a revenue growth of around 15% in FY2023, with its operating margins likely to moderate by around 100-150 basis points. Over the medium term, ICRA anticipates SPAL to continue to register a steady revenue growth of around 10%, given the increasing shift in procurement by large US and EU-based customers from China to other markets including India. Market players like SPAL are expected to benefit from this shift, especially in the infant wear market as China caters to the major part of the requirements and India also holds an edge over other competing nations in this segment.

Post the deterioration witnessed in FY2021, SPAL's debt protection metrics improved in FY2022 backed by the strong earnings with interest cover and net debt-to-operating profit ratio improving to an estimated 12.0 times and 1.1 times, respectively. The capital expenditure, to be incurred in the near-to-medium term, is likely to be limited, given the adequate unutilised capacities and the company's plans of utilising the existing capacities through additional shift over the medium term. ICRA expects capital expenditure of around Rs. 150-200 crore, to be incurred between FY2023 and FY2025, largely funded by internal accruals. Thus, with an expected improvement in earnings in FY2023, key credit metrics including the interest cover and the net debt-to-operating profit ratio are estimated to remain strong at around 13.0 times and 1.0 times, respectively. While the revenue concentration towards its large customers and key geographies remains high, with its top three customers contributing 80-90% to the revenues, recurring orders received over the years provide some comfort. ICRA expects concentration towards the top customers to reduce gradually over the medium term with the ongoing addition of new customers. The ratings also consider the continued weak performance in the domestic retail segment and low margins enjoyed by the UK subsidiary, which constrains the consolidated profitability. The company is also exposed to external factors such as foreign exchange fluctuations, regulations, and duty structures across the markets. Besides, the ratings consider the exposure of earnings to fluctuations in input prices and the high working capital requirements inherent in the business.

The Stable outlook reflects ICRA's expectation that SPAL's operational and financial performance 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, which are expected to improve value addition and operating efficiency, as witnessed in the recent quarters. Recovery in demand coupled with these operational strengths helped SPAL in registering healthy growth in revenues and earnings in FY2022 (despite the disruptions witnessed in Q1 FY2022), and the operating performance is expected to remain strong over the medium term.

Strong financial profile – Healthy earnings from operations and no major capital expansion have continued to support SPAL's financial profile despite the moderately high working capital intensity. The same is evident from its key credit metrics remaining at comfortable levels over the years, even during periods of Covid disruptions. Key leverage indicators including the gearing and the net debt-to-operating profit ratio are estimated to have remained at 0.4 times and 1.1 times, respectively in FY2022. Backed by the growth in earnings, SPAL's coverage indicators including interest coverage and debt service coverage ratios are estimated to have improved further in FY2022 to strong levels of around 12.0 times and 5.0 times, respectively and are expected to remain at healthy levels over the medium term.

Credit challenges

Customer concentration risk remains high; widening client base to mitigate the risk to some extent over the medium term – SPAL's top three customers contributed 80-90% to its revenues in FY2021 and FY2022. 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 repeat orders, strong market position of its customers in key end user markets and the recent addition of new customers. The fact that some of the recently added customers have contributed to around 10% of the revenues in the recent fiscal and SPAL's continued steps to further diversify its revenue base provide comfort.

Earnings exposed to fluctuations in input prices – 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 more than 80% of the receivables hedged in stages upon order confirmation from customers.

Liquidity position: Strong

SPAL's liquidity position is expected to be **strong** over the coming quarters, supported by 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. 130 crore as on March 31, 2022. The average working capital utilisation stood at around 65% during the last 12 months ended March 2022. As against the expected capital expenditure requirements of around Rs. 150-200 crore, to be incurred over the medium term to meet growth requirements and low debt repayment obligations of Rs. 15-17 crore per annum, SPAL's cash flows are expected to be supported by earnings of around Rs. 100 crore per annum apart from the cash buffer enjoyed by the company.

Rating sensitivities

Positive factors – SPAL's ratings 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 Rating Methodology for Entities in the Textile Industry - Apparels
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. As on March 31, 2022, SPAL had two subsidiaries, which are listed in Annexure-2.

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 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 and markets its apparels under the Crocodile brand and trades in essentials in the domestic market.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)	9M FY2022 (Provisional)
Operating Income (Rs. crore)	830.8	652.3	610.4
PAT (Rs. crore)	46.2	43.6	59.4
OPBDIT/OI (%)	12.7%	16.2%	18.3%
PAT/OI (%)	5.6%	6.7%	9.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.6	-
Total Debt/OPBDIT (times)	2.1	1.8	-
Interest Coverage (times)	4.6	7.4	13.6

Source: SPAL, ICRA Research; All ratios as per ICRA calculations

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

Note: The above figures for the operating profit have been adjusted for realised and unrealised exchange gains

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument		Current Rating (FY2022)			Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	
					11-May-2022	09-Mar-2021	24-Apr-2020	01-Jul-2019	07-Jan-2019	06-Jul-2018
1	Fund-based Term Loans	Long-term	52.73	51.34	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Fund-based Working Capital Facilities (Sublimits)	Long-term	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
3	Fund-based Working Capital Facilities	Short-term	190.00	-	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
4	Fund-based Working Capital Facilities (Sublimits)	Short-term	-	-	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
5	Non-fund Based	Short-term	23.00	-	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	-
6	Unallocated Limits	Long-term/ Short-term	11.57	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long-term – Fund-based Term Loans	Simple
Short-term – Fund-based Working Capital Facilities	Simple
Short-term – Non-fund Based	Very Simple
Long-term / Short-term 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Term Loans	FY2017-FY2021	7.95 - 8.75%	FY2023-FY2026	52.73	[ICRA]AA-(Stable)
NA	Working Capital Limits	-	-	-	190.00	[ICRA]A1+
NA	Letter of Credit/Bank Guarantee	-	-	-	23.00	[ICRA]A1+
NA	Unallocated Limits	-	-	-	11.57	[ICRA]AA-(Stable)/[ICRA]A1+

Source: *SPAL*

Annexure-2: List of entities considered for consolidated analysis

Sr.	Entity Name	Consolidation Approach
1	S.P. Apparels Limited	Full consolidation
2	Crocodile Products Private Limited	Full consolidation
3	S.P. Apparels (UK) (P) Limited	Full consolidation

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