Zodiac Clothing Company Limited

April 06, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term fund-based facilities	70.0	70.0	Downgraded to [ICRA]A2+ from [ICRA]A1
Short-term non fund-based facilities	10.0	10.0	Downgraded to [ICRA]A2+ from [ICRA]A1
Commercial Paper programme	20.0	0.0	Downgraded to [ICRA]A2+ from[ICRA]A1 and withdrawn
Total	**100.0**	**80.0**	

* Instrument details are provided in Annexure-1

Rating action

ICRA has revised the rating on the Rs. 70.0-crore[1], short-term fund-based facilities and the Rs. 10.0-crore non-fund based facilities of Zodiac Clothing Company Limited (ZCCL) to ICRA]A2+ (pronounced ICRA A two plus) from [ICRA]A1 (pronounced ICRA A one). ICRA has downgraded the rating on the Rs. 20.0-crore Commercial Paper programme and also withdrawn the rating upon the company's request as the company had not availed of the limits and there is no amount outstanding against the same.

Rationale

The rating revision factors in the continued weak business and financial performance for the last couple of years, reflected in the YoY decline in revenues and operating losses during the period leading to the deterioration in debt protection metrics. The export business remained under pressure because of weak consumer off-take in the key markets of the US, the UK and the Middle East, though the UK business displayed some resilience. Additionally, the change in duty drawback rates, post introduction of the Goods and Services Tax (GST) has also impacted the competitiveness of the Indian readymade garment exporters. The top-line of the domestic business was impacted during 9M FY2018 by the closure of 20 non-performing stores during FY2017 and a further closure of three stores during 9M FY2018; additionally, consumer sentiments were weak and competitive intensity remained high. The YoY decline in revenues resulted in under-absorption of fixed costs, and consequently in operating loss.

The rating, nevertheless continues to factor in the extensive experience of the promoters of ZCCL in the readymade garments business; its professional management team, low gearing and adequate market value of its strategic investments. The domestic business, which suffered a sharp slowdown due to demonetisation and GST implementation in the past, has reported some recovery in the last couple of quarters – the sustainability of the recovery, however, would be critical to achieve the scale benefits necessary in the business. ICRA continues to draw comfort from its holding of listed liquid investments, though the buffer has reduced as the company has liquidated part of this to fund its business. Further, collection of its Rs. 24.5 crore receivables from its sale of its second level subsidiary holding properties in the UK during FY2017 would help support the working capital position for its overseas business. ICRA continues to acknowledge the company's established brands in the premium men's wear category and their niche positioning in the

[1] *100 lakh = 1 crore = 10 million*

branded garments industry. In the exports market, the business is supported by its in-house design capabilities and the long-term relationships that ZCCL enjoys with its customers.

Going forward, improvement in business prospects and consequently profitability and maintaining adequate liquidity through various measures will be crucial to support its credit profile.

Key rating drivers

Credit strengths

Promoters have vast experience in the business supported by a sound management team - The promoters have more than forty years' experience in the readymade garment business and are backed by an able management team.

Established brand name with focus on the premium segment in the domestic markets through its branded business; signs of turnaround in domestic business with positive like-to-like growth - The company has strong brands in the domestic market in the premium category, represented by Zodiac, ZOD! And Z3 having niche positioning in the formal wear, clubwear and relaxed casual wear categories respectively. The domestic business, which has been undergoing a challenging phase in the past couple of years because of macro-economic factors and intense competition, has reported some recovery with positive like-to-like (LTL) growth in the current fiscal. Nevertheless, sustainability of the recovery would be critical to achieve the scale benefits necessary in the business.

Strong design focus in exports business and established overseas customer base - The company has an established track record and long relationship in the exports business backed by its in-house designing capabilities. The company's design focus has enabled it to register higher-than-domestic industry export price realisation and helped it compete effectively in the domestic market.

Track record of low gearing and value of listed strategic investment adds to financial flexibility - The company has a track record of maintaining a conservative capital structure (0.23 times as on March 31, 2017) and limiting its external borrowings. ICRA derives comfort from the value of the company's listed investment (around Rs. 26 crore at present) which the company has liquidated in the past to contain its borrowings and fund its losses in the recent past.

Credit challenges

Loss continues in 9M FY2018; margin rebound dependant entirely on demand pick-up across markets - The company reported a standalone PAT loss of Rs. 16.3 crore (before comprehensive income) during 9M FY2018 as it reported a decline in volumes for both its domestic and export market leading to under-absorption of overhead costs. Pickup in demand across markets would be critical to support the company's growth and reverse its adverse margin trajectory during the subsequent quarters.

Highly competitive nature of the readymade garments business - The domestic branded apparel business remains highly competitive with several domestic and international brands competing for the consumer's wallet share. ZCCL has a policy of non-discounting, holding only a single annual sale unlike the other brands which are perennially on discounting. This has put a strain on the company's growth since it results in lower footfalls for its own stores. However, the company's recent innovations including introducing high value-added collections has helped it attract footfalls and partly offset volume decline.

Vulnerable to inherent industry risk of accurately predicting fashion trends and change in consumer tastes - The company faces the inherent risk of accurately predicting fashion trends and change in consumer tastes which could make the inventory vulnerable to markdowns and lead to higher working capital intensity.

Competition from other low-cost countries and exchange risk for its significant export sales - The company's exports to its key geographies, Europe, North America and the Gulf Co-operation Council (GCC) region faces stiff competition from other low-cost countries such as Bangladesh, Vietnam, Cambodia and Morocco, which have duty advantage and labour arbitrage compared to India. Further, the recent change in duty drawback rates, post introduction of the GST has also impacted the competitiveness of Indian exporters.

Timely measures to support liquidity crucial - The company will require capital to fund its near-term quarterly losses, meet its growth commitments and service its debt obligations and continue on its recovery path. Timely infusion of funds through various measures including liquidation of existing investments will thus be crucial.

Analytical approach: For arriving at the ratings, ICRA has analysed consolidated annual and quarterly standalone results of the company.

Links to applicable criteria:

Corporate Credit Rating Methodology
Indian Textiles Industry - Apparels

About the company:

Promoted by Mr. M.Y. Noorani, the House of Zodiac commenced operations as a partnership firm in 1954 for manufacturing neckties. Zodiac Clothing Company Limited (ZCCL) was incorporated in 1984 and came out with an initial public offer in 1994. It started exporting readymade garments, mainly neckties and shirts, in the 1960s. Most of its current exports are made to Europe and North America. ZCCL entered the branded shirt business in India in the late '70s, when it positioned itself in the premium men's wear segment. Currently, ZCCL is present in men's formal wear through its flagship brand, "Zodiac", in party/club wear through its sub-brand, "ZOD!", and in relaxed casual wear through its sub-brand, "Z3", launched in 2008. All these three brands are under a perpetual licensing arrangement from its Group company, Metropolitan Trading Company (MTC), a partnership firm that is 100% owned by the promoters. MTC charges a royalty of 1% over the annual turnover from ZCCL. In the exports segment where it focuses on design-driven value addition, it is present mainly in the men's casual wear and semi-formal wear categories. The readymade garments export business accounts for almost 53% of its turnover (FY2017), while the domestic branded business contributes the rest.

The branded business is mainly routed through three retail channels—exclusive outlets (EBOs) also referred to as own retail by ZCCL, multi-brand outlets (MBOs) and large format stores (LFS) of organised retailers. The company has over 1,200 MBOs spread across Tier I and II cities in the country. Its 124 EBOs (as on December 31, 2017) are mainly concentrated in Tier I cities, with the rest being spread across Tier II and III cities and towns. ZCCL's manufacturing facilities are in Karnataka and Gujarat in India.

Key financial indicators (Audited, Consolidated)

	FY 2016	FY 2017
Operating Income (Rs. crore)	348.9	281.9
PAT (Rs. crore)	-8.2	6.1
OPBDIT/ OI (%)	1.6%	-3.6%
RoCE (%)	-1.0%	4.0%
Total Debt/ TNW (times)	0.3	0.2
Total Debt/ OPBDIT (times)	12.9	-5.9
Interest Coverage (times)	1.1	-1.7
NWC/ OI (%)	28%	41%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth (TNW) + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

*Adjusted for excess provisions for taxation in respect of earlier years written back

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating April 2018	Date & Rating in FY2018 March 2017	Date & Rating in FY2017 August 2016	Date & Rating in FY2016 July 2015
1	Fund based facilities	Short Term	70.0	-	[ICRA]A2+	[ICRA]A1	[ICRA]A1+	[ICRA]A1+
2	Non-fund based facilities	Short Term	10.0	-	[ICRA]A2+	[ICRA]A1	[ICRA]A1+	[ICRA]A1+
3	Commercial Paper	Short Term	20.0	0.0	Revised from [ICRA]A1 to [ICRA]A2+ and withdrawn	[ICRA]A1	[ICRA]A1+	[ICRA]A1+

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Short-term fund-based limits	-	NA	NA	70.00	[ICRA]A2+
NA	Short-term non-fund-based limits	-	NA	NA	10.00	[ICRA]A2+
NA	Commercial Paper	Not placed	NA	NA	20.00	[ICRA]A2+ withdrawn

Source: Zodiac Clothing Company Limited

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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.

For more information, visit www.icra.in

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