September 23, 2019

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	75.0	[ICRA]AA-(Stable); reaffirmed
Long-term fund-based bank facility (term loan)	16.0	26.1	[ICRA]AA-(Stable); reaffirmed
Long-term unallocated	29.0	18.9	[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	50.0	[ICRA]A1+; reaffirmed
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 of exclusive brand outlets (EBOs), multi-brand outlets (MBOs) and large format stores/ national chain stores (NCS) across more than 700 cities in the country. 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 0.5x and interest coverage of 11.0x for FY2019). 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, and 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 long-term rating is 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

[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).

model for most of the sales with limited provision for sales returns partially mitigates the risk of obsolete inventory due to unsold stock.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's opinion that MCFL will continue to benefit from its strong brand presence in the domestic apparel market, an established multi-channel distribution network and its consistent efforts to diversify its product portfolio and geographical reach, which will support steady revenue growth and healthy profitability in the medium term. Coupled with a low dependence upon debt, this is expected to continue 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 256 EBOs, over 2,500 MBOs and 306 NCSs as on March 31, 2019, across more than 700 cities in the country. 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 – 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 ~0.1x as on March 31, 2019). Further, the company continues to maintain sizeable free cash and liquid investments (~Rs. 170 crore as on March 31, 2019), 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 in total debt/OPBDITA of 0.5x and interest coverage of 11.0x for FY2019.

Strong liquidity profile – MCFL's liquidity profile is characterised by sizeable cash and liquid investment balances and adequate undrawn working capital limits during the year (average utilisation level of 51% vis-à-vis borrowing capacity[2] during the past 12 months). However, 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 85% of the borrowing capacity) during these months. Nonetheless, ICRA takes comfort from the recent enhancement in cash credit limits to Rs. 125 crore from Rs. 75 crore, which will provide additional liquidity cushion during the peak months, as the drawing power typically remains much higher than the sanctioned fund based working capital limits of the company.

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 to garmenting and 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.

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[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*

[3] *ICRA has rating outstanding of [ICRA]A+(Negative) and [ICRA]A1+ for Oswal Woollen Mills Limited*

[4] *ICRA has rating outstanding of [ICRA]A-(Stable) and [ICRA]A2+ for Nahar Industrial Enterprises Limited*

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

Credit challenges

High brand, segment (winter-wear) 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 apparel. 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 geographies, 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 the distribution channel partners. The apparel inventory level is high because of stocking of apparels before the season to meet the requirement of the existing stores and the new stores, which are opened during the season. Further, the working capital requirements 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.

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. 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. This was also witnessed in FY2019, wherein the operating margin declined to 15.0% from 19.6% in FY2018 to maintain market share.

Liquidity position: Strong

MCFL's liquidity position remains **strong** with healthy cash flow from operations (~Rs. 61 crore in FY2019), nominal repayment obligations (~Rs. 6 crore in FY2020), adequate cushion in sanctioned working capital limits (average utilisation level of 51% vis-à-vis borrowing capacity during the 12-month period ended August 2019) and sizeable free cash and liquid investments (~Rs. 170 crore as on March 31, 2019). Further, ICRA also derives comfort from the recent enhancement in cash credit facility to Rs. 125 crore from Rs. 75 crore, which provides additional liquidity position to the company for the peak months. 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 ~85% of the borrowing capacity). As a result, MCFL's ability to maintain comfortable cash flows and liquidity during the peak season through efficient working capital cycle and fund management remains crucial.

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 geographies, which facilitates reduced seasonality in revenue as well as working capital requirements and supports a sustained improvement in revenues and return metrics could be a positive trigger for the rating.

Negative triggers – The ratings could be downgraded if MCFL undertakes aggressive debt-funded investments/ acquisitions or experiences a significant stretch in its working capital cycle, which weakens its liquidity profile, taking the average utilisation to more than 90% vis-à-vis borrowing capacity during the peak months on a sustained basis and/or results in an increase in MCFL's leverage. Additionally, MCFL's rating would be prone to a downgrade if its competitive position weakens, exerting pressure on sales growth and profitability, and resulting in a decline in its return indicators.

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 woollen-wear segment. MCFL has an established multi-channel distribution network comprising 256 EBOs, over 2,500 MBOs and 306 NCSs as on March 31, 2019, 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 to garmenting and retailing. The 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 under the brand has been diversified to include summer-wear as well. Further, the company has also expanded its brand portfolio by launching brands such as Denim, Alpha, Rock-it, and Cloak & Decker.

In FY2019, the company reported a net profit of Rs. 59.6 crore on an operating income of Rs. 656.4 crore, compared to a net profit of Rs. 67.9 crore on an operating income of Rs. 575.9 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	575.9	656.4
PAT (Rs. crore)	67.9	59.6
OPBDIT/OI (%)	19.6%	15.0%
RoCE (%)	19.5%	17.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.6
Total Debt/OPBDIT (times)	0.5	0.5
Interest Coverage (times)	14.7	11.0
DSCR	4.0	7.4

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020) Type	Amount Rated	Amount Outstanding	Rating 23-Sep-2019	Rating History for the Past 3 Years FY2019 12-Nov-2018	FY2019 17-May-2018	FY2018 18-Oct-2017	FY2017 22-Sep-2016
1	Cash credit	Long Term	75.0	NA	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
2	Term loan	Long Term	26.1	26.1	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
3	Unallocated limits	Long Term	18.9	NA	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
4	Letter of Credit	Short Term	30.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Overdraft	Short Term	50.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
6	Bank Guarantee^	Long Term/ Short Term	(10.0)	NA	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	-	-
7	Commercial Paper	Short Term	100.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
8	Bank Guarantee	Long Term	-	-	-	-	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)

Amount in Rs. crore; ^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	75.0	[ICRA]AA- (Stable)
NA	Term Loan 1	FY2015	NA	FY2024	12.8	[ICRA]AA- (Stable)
NA	Term Loan 2	FY2019	NA	FY2022	13.3	[ICRA]AA- (Stable)
NA	Unallocated limits	NA	NA	NA	18.9	[ICRA]AA- (Stable)
NA	Letter of Credit	NA	NA	NA	30.0	[ICRA]A1+
NA	Overdraft	NA	NA	NA	50.0	[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

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