September 30, 2019

Sportking India Limited: Ratings downgraded to [ICRA]BBB(Stable)/[ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facilities	524.03	494.48	[ICRA]BBB(Stable); downgraded from [ICRA]BBB+ (Stable)
Short-term non-fund-based bank facilities	75.61	75.61	[ICRA]A3+; downgraded from [ICRA]A2
Unallocated bank facilities	0.36	29.91	[ICRA]BBB(Stable); downgraded from [ICRA]BBB+ (Stable)
Total	**600.00**	**600.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating downgrade factors in an expected moderation in the financial risk profile of Sportking India Limited (SIL) during FY2020, owing to demand-side pressures being witnessed in the domestic spinning sector and resultant pressure on cotton yarn realisations as well as contribution margins of domestic spinners. While SIL has successfully ramped-up its enhanced capacities and is expected to achieve a healthy volumetric growth during FY2020, pressure on profitability is likely to result in a moderation in its debt coverage metrics (estimated DSCR at less than 1.3 times and estimated interest cover at less than 3 times) in the near term, given the leveraged capital structure. Besides, a delay in enhancement of working capital limits from the Banks has resulted in an increase in average (fund-based and non-fund based) working capital limit utilisation (from ~63% in FY2018 to ~84% in FY2019 and further to 87% in 4M FY2020), which together with higher creditor turnover period reflects a weakening of the company's liquidity profile. Going forward, SIL's ability to sustain the healthy capacity utilisation levels for the enhanced capacity as well as withstand the pressures on profitability alongwith its ability to efficiently manage working capital will be the key determinants of its cash flows and hence credit profile. The company's ability to timely tie-up adequate working capital limits also remains crucial for its liquidity profile, and thus remains a key rating sensitivity.

The ratings remain constrained by the company's leveraged capital structure given the fixed as well as working capital intensive nature of operations, limiting its financial flexibility. The seasonal nature of cotton availability necessitates stocking during the harvest season, which besides keeping the dependence upon debt high, keeps profitability vulnerable to volatility in cotton prices. Further, commoditised nature of yarn and intense competition in the industry due to its fragmented nature will keep the profitability under check. Moreover, as SIL derives ~50-60% of its revenues from exports, its profitability remains dependent on its ability to effectively hedge its export receivables on a consistent basis and on demand in the key export markets. Notwithstanding the above, the ratings continue to derive comfort from SIL's established track record of almost three decades in the cotton spinning industry, its large scale of operations with an installed capacity of 2.7 lakh spindles and its strong operational performance with consistently healthy capacity utilisation supported by its diversified product offerings.

Key rating drivers and their description

Credit strengths

Track record of almost three decades in the spinning industry, with an established market position – Having commenced operations in 1993 with an installed capacity of 6,520 spindles, SIL has an established track record of almost three decades in the spinning industry. Over the years, SIL has expanded its installed capacity to ~272,000 spindles (including ~68,000 spindles commissioned in March 2019), strengthened its distribution network, diversified its product range and forward integrated its operations by setting up an in-house yarn-dyeing capacity of 20 tons per day (tpd). Given the established market position in the industry with long standing relationships with clients and a diversified/ value-added product profile, capacity utilisation for SIL's units has consistently remained healthy, averaging more than 90% in most years.

Economies of scale resulting from large scale of operations- SIL is a Punjab-based spinner having a capacity of 2,72,000 spindles at two locations, which is large compared to an average capacity of ~28,000-30,000 spindles per unit in India. The large scale in yarn manufacturing augurs well for its cost structure in a commoditised market, providing benefits from economies of scale.

Diversified product portfolio and presence in value-added products, which provides flexibility and facilitates healthy capacity utilisation - SIL manufactures yarn across a wide count range (from 12s to 40s counts, though mainly concentrated on medium count yarns) and varieties (comprising grey and dyed cotton, cotton polyester and acrylic yarn). It also focuses on value-added products, such as compact yarn, dyed yarn and double yarn, which results in healthy contribution margin. Besides improving the extent of value addition, a diversified product portfolio within yarn segment provides flexibility to SIL to switch among product offerings, depending upon the demand scenario. This is corroborated from the company's demonstrated ability to consistently maintain a healthy capacity utilisation. During the current year as well, the company has reported an average capacity utilisation of 94% (till August 2019) despite demand-side pressures and enhanced capacity operational now.

Credit challenges

Leveraged capital structure; sizeable repayment obligations in the medium term – Given the fixed as well as working-capital intensive nature of operations and the access to subsidised loans for capacity expansion in the past, SIL's dependence upon debt, similar to other domestic spinning companies, has remained high over the years. The recently concluded sizeable capex programme of ~Rs. 265 crore has resulted in a further increase in its debt levels and leverage, as reflected by TOL/ TNW, to ~3.60 times as on March 31, 2019 vis-a-vis 3.09 times as on March 31, 2018. Further, the repayment obligations are sizeable at ~Rs. 55-65 crore annually over FY2020-2022, which will taper down to less than Rs. 25 crore per annum only from FY2023 onwards. With sizeable repayment obligations in the near to medium term, increased interest burden (owing to recently completed debt-funded capex, and increased proportion of term loans not eligible for any subsidy benefit), alongside an expected moderation in operating profitability during FY2020 is likely to result in a moderation in SIL's debt coverage metrics. Going forward, SIL's ability to sustain the healthy capacity utilisation levels as well as withstand profitability pressures, while effectively managing its working capital cycle will remain crucial determinants of its cash flows and hence its credit profile in the near to medium term.

Moderation witnessed in liquidity profile –Although SIL's cash accruals remain adequate vis-a-vis its repayment obligations, the company's liquidity profile has moderated owing to recently concluded capital expenditure programme which necessitated deployment of surplus accruals towards capex funding in the recent years. Further, company's working capital requirements have increased, with an increase in scale of operations. This is also reflected in an increase in its average working capital (fund-based as well as non-fund based) limit utilisation from ~63% in FY2018 to ~87% during 4M FY2020. This was despite an increase in reliance on use of imported cotton, which facilitated extended credit period for the company because of the time involved in transit (corroborated by an increase in creditor turnover period to 51 days in FY2019 from 20 days in FY2018[1]). Going forward, while the capex requirements remain minimal, timely sanction of enhanced limits remains imperative to maintain comfortable liquidity given the increased scale of operations.

Commoditised nature of products and fragmented industry structure results in limited pricing power-The commoditised nature of yarn and the intense competition results in limited pricing power, keeping profitability under check. While SIL manufactures a wide variety of yarns with varying levels of value addition, its product portfolio continues to be concentrated towards medium-count yarns, which limits pricing power and keeps profitability under check.

Susceptibility of profitability to volatility in cotton and cotton yarn prices, demand trends in key export markets and currency movements - Similar to other entities in the cotton spinning sector, SIL stocks cotton during the harvest season, (October to March) to meet a significant portion of its requirement during the remaining season. This stocking of cotton exposes the company to fluctuations in cotton and hence cotton yarn prices during the non-harvest period. This is because procurement cost for the company gets fixed, while yarn realisation fluctuates depending on market conditions as well as movement in cotton prices, which are driven by both domestic and global factors. This also results in a high dependence upon working capital borrowings and keeps the leverage high, particularly at year end. Further as SIL derives ~50-60% of its revenues from exports, it remains vulnerable to demand in key exports markets (China and Bangladesh) and its profitability remains dependent on its ability to effectively hedge export receivables on a consistent basis.

ICRA expects the performance of domestic cotton spinners to weaken in FY2020, following a brief recovery in FY2019, as they are grappling with the twin challenges of weak export demand and uncompetitive cotton prices. Besides challenges in maintaining volumetric growth, a sharper decline in realisations vis-a-vis cotton prices because of higher minimum support price (MSP)-led floor price for cotton are expected to result in a compression in operating profitability of domestic cotton spinners during the year FY2020.

Liquidity position: Stretched

Although ICRA expects SIL's cash accruals to be adequate to service annual repayment obligations as well as margin requirement for working capital, its liquidity profile has been stretched owing to working capital intensive nature of operations and increasing scale of operations. This is corroborated by consistently high utilisation of its sanctioned working capital facilities (~86% average working capital utilisation in the six months ended July 2019) and reliance on increased creditor turnover period, amid delays in sanction of enhanced working capital limits. As cotton stocking for the

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[1] Creditor days arrived at exclude acceptances payable (Rs. 65.23 crore as on March 31, 2019, and Rs 41.95 crore as on March 31, 2018).

next year is likely to start from October onwards with commencement of the cotton harvest season, company's limit utilisation is likely to remain high in the near term, with limited cushion in working capital facilities.

Rating sensitivities

Positive triggers – ICRA could upgrade SIL's rating if there is a significant and sustained improvement in the company's capitalisation and debt coverage indicators (Debt/OPBDITA below 3 times, interest cover more than 5 times), supported by improvement in scale, profitability and working capital cycle. Additionally, improvement in liquidity supported by enhancement in working capital limits or reduced working capital intensity, will be crucial for an improvement in company's credit profile.

Negative triggers – Negative pressure on SIL's ratings could arise if the liquidity position weakens further, reflected by consistently high dependence on creditors or increase in WC utilisation beyond 90% on a sustained basis, owing to a stretch in working capital cycle and/ or a delay in sanction of enhanced working capital limits. Besides, sub-optimal utilisation of enhanced capacity and/or a steep decline in operating margins, which results in a decline in interest cover to less than 2 times and/or DSCR to less than 1.1 times would also be downgrade triggers. While ICRA notes that the company does not have any major capital expenditure plans at present, any incremental sizeable debt-funded capital outlay, which adversely affects company's capitalisation metrics, will also be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Indian Textiles Industry- Spinning
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financial statements of SIL.

About the company

SIL, which was incorporated in 1989 and is promoted by Mr. Raj Kumar Avasthi, manufactures cotton, cotton polyester-blended, and acrylic-blended yarn in grey and dyed forms with an installed capacity of 272,880 spindles (including 68,256 new spindles commissioned in March 2019). The company's manufacturing facilities are located in Ludhiana and Bathinda (both in Punjab).

SIL is the flagship company of the Ludhiana-based Sportking Group which is a vertically-integrated textile group with presence in segments ranging from spinning to garment manufacturing and retailing. The garments are retailed by the Group companies under the Sportking and Mentor brands, through both exclusive and multi-brand stores. SIL supplies yarn to the Group companies that are engaged in knitting and garmenting.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income or OI (Rs. crore)	1,061.15	1,158.75
PAT (Rs. crore)	19.16	24.02
Operating Profit before Depreciation, Interest & Tax (OPBDIT)/OI (%)	10.30%	11.14%
Return on Capital Employed (RoCE) (%)	7.84%	10.42%
Total Outside Liabilities/Tangible Net Worth (times)	3.09	3.60
Total Debt/OPBDIT (times)	4.76	4.41
Interest Coverage (times)	3.76	3.27
Debt Service Coverage Ratio (DSCR) (times)	1.43	1.26

Note: Tangible Net-worth factors 90% equity credit for Rs 63.61 crore Preference share capital subscribed by promoters; with balance taken under Debt

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2020)			Current Rating	Earlier Rating	Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	30-Sep-2019	20-Jun-2019	FY2019	FY2018		FY2017
							10-Aug-2018	25-Sep-2017	29-Jun-2017	16-Aug-2016
1	FB bank facilities (Term Loans)	Long Term	279.48	279.48	[ICRA]BBB (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
2	FB bank facilities (Working Capital)	Long Term	215.00	-	[ICRA]BBB (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
3	NFB bank facilities	Short Term	75.61	--	[ICRA]A3+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
4	Unallocated bank facilities	Long Term	29.91	--	[ICRA]BBB (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)

Amount in Rs. Crore

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. Cr)	Current Rating and Outlook
NA	Term Loan-1	Mar-2010	9.50%	FY2020	2.50	[ICRA]BBB (Stable)
NA	Term Loan-2	Jun-2011	9.50%	FY2022	29.41	[ICRA]BBB (Stable)
NA	Term Loan-3	Jun-2011	9.40%	FY2022	25.48	[ICRA]BBB (Stable)
NA	Term Loan-4	Nov-2011	9.50%	FY2022	11.76	[ICRA]BBB (Stable)
NA	Term Loan-5	May-2011	9.50%	FY2022	20.44	[ICRA]BBB (Stable)
NA	Term Loan-6	Oct-2017	9.50%	FY2023	3.25	[ICRA]BBB (Stable)
NA	Term Loan-7	Dec-2013	9.50%	FY2024	17.81	[ICRA]BBB (Stable)
NA	Term Loan-8	Jun-2018	10.30%	FY2028	98.83	[ICRA]BBB (Stable)
NA	Term Loan-9	Sep-2018	9.75%	FY2028	20.00	[ICRA]BBB (Stable)
NA	Term Loan-10	Sep-2018	9.50%	FY2028	50.00	[ICRA]BBB (Stable)
NA	Cash Credit	Oct-2017	9.50%	NA	215.00	[ICRA]BBB (Stable)
NA	Short- term non-fund-based limits	Oct-2017	NA	NA	65.00	[ICRA]A3+
NA	Credit Exposure Limit	Oct-2017	NA	NA	10.61	[ICRA]A3+
NA	Unallocated bank facilities	NA	NA	NA	29.91	[ICRA]BBB (Stable)

Source: Sportking India Limited

Annexure-2: Not applicable

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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.

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