October 05, 2020

Zodiac Clothing Company Limited: Rating revised to [ICRA]A3+ from [ICRA]A2

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action[1]
Short-term fund-based/non-fund based facilities	0.0	65.0	Revised to [ICRA]A3+ from [ICRA]A2
Short-term fund-based facilities	70.0	0.0	-
Short-term non fund-based facilities	10.0	0.0	-
Total	**80.0**	**65.0**	

** Instrument details are provided in Annexure-1*

Rationale

The rating revision factors in the continued deterioration in business and financial risk profile of Zodiac Clothing Company Limited (ZCCL), as reflected by its continued decline in revenues and net loss during FY2020, further accentuated by the ongoing Covid-19 pandemic. The export business remained under pressure during FY2020 because of subdued consumer off-take in the key markets of the US, the UK and the Middle East, as well as competition from other low-cost markets, which was exacerbated after reduction in export incentives, post the introduction of the Goods and Services Tax (GST). The top line of the domestic business during FY2020 remained under pressure due to weak consumer sentiments and high competitive intensity. Further, with liquidity of multi-brand outlets across the country under duress, the sales to them witnessed YoY decline. The nationwide pandemic related lockdown imposed from March 2020 onwards adversely impacted the company's domestic retail business during Q1 FY2021. This was particularly severe across metros where the company has a large presence. While the exports business fared relatively well post opening of its manufacturing facilities in May 2020, high operating leverage of the company led to widening of the loss during the quarter.

The rating, nevertheless, favourably factors in the extensive experience of the promoters of ZCCL in the readymade garments business, its professional management team, low gearing and track record of financial support from the promoters. ICRA continues to acknowledge the company's established brands in the premium men's wear category and their niche positioning in the 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. ICRA notes the company's strong focus on cost cutting since the beginning of Q1 FY2021 and conversion of fixed rental arrangements for most of its stores into revenue sharing ones which will help contain costs for balance of the year. Nevertheless, a palpable revival in revenues would remain crucial for turning around its profitability.

Going forward, ICRA would continue to monitor the company's quarterly performance. A lack of meaningful revival in the domestic and export businesses and an adverse liquidity position would be key rating triggers.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

Key rating drivers and their description

Credit strengths

Promoters with vast experience in the business, supported by a sound management team - The promoters have more than 40 years' experience in the readymade garment business and are backed by an able management team.

Established brand name, niche positioning in the premium segment of the domestic market through branded business - The company has strong domestic brands in the premium category, represented by Zodiac, ZOD! and Z3 with their niche positioning in the formal wear, club wear and casual wear categories, respectively. The domestic business, which was already under pressure because of macro-economic factors and intense competition, is expected to remain adversely impacted, given the anticipation of a gradual recovery because of the pandemic. A meaningful improvement in the operating performance would be critical to achieve the scale benefits necessary for the business.

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

Low gearing and track record of financial support from the promoters - The company has maintained a conservative capital structure (0.23 time as on March 31, 2020) and limited its dependence on external borrowings despite incurring significant losses in the past three years. This has been aided by liquidation of its market investments and significant financial support to the company from the promoters though infusion of equity and unsecured loans. While the promoters had infused Rs. 50 crore equity during FY2019 and H1 FY2020, they brought in a further Rs. 16.7-crore of unsecured loans in Q4 FY2020, which helped reduce the company's external borrowings to Rs. 43.0 crore as on March 31 2020 from Rs. 63.7 crore as on March 31 2019.

Credit challenges

Shrinking revenue base led to losses; given the uncertain macro-economic scenario, performance to remain under pressure - The company reported a net loss of Rs. 37.3 crore (before comprehensive income) during FY2020 as volumes remained subdued for both its domestic and export markets, leading to under-absorption of overhead costs. The Government initiated lockdown in March 2020 adversely impacted the company's domestic business in Q1 FY2021 as most of its stores in metro cities remained closed. The exports did relatively well, resulting in revenues of Rs. 11.9 crore during Q1 FY2021. However, given the operating leverage of the business, the company reported a net loss of Rs. 14.5 crore during the quarter. Given the uncertain macro-economic scenario and any further headwinds, which may arise due to future restrictions on account of the pandemic, sales revival is expected to be gradual. ICRA notes the company's strong focus on cost cutting since the beginning of Q1 FY2021 and conversion of fixed rental arrangements for most of its stores into revenue sharing ones which will help contain costs for balance of the year. Nevertheless, a palpable revival in revenues would remain crucial for turning around its profitability.

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 many other fashion brands. This has put a strain on the company's growth since it results in lower footfalls into its own stores. The company's innovations and focus on introducing high value-added collections, which has supported value growth, however, have been able to completely offset the volume decline.

Vulnerable to inherent industry risk of accurately predicting fashion trends and change in consumer tastes - Though the company's exports business is order-backed, its domestic business faces the inherent risk of accurately predicting fashion trends and changes in consumer tastes, which could make the inventory vulnerable to markdowns and lead to higher working capital intensity. As per the management, its fashion inventory under ZOD! And Z3 are more vulnerable to markdowns than its formal wear category under Zodiac. Increase in competitive intensity and a higher discounting trend post opening of the markets could put further strain on the company's performance.

Competition from other low-cost countries and exchange risk for its significant export sales - ZCCL's exports to its key geographies of Europe, North America and the Gulf Co-operation Council (GCC) region faces stiff competition from low-cost countries such as Bangladesh, Vietnam, Cambodia, Morocco and other African countries, which enjoy duty advantages and labour arbitrage compared to India. Apart from currency fluctuation, change in the export incentive structure also impacts the competitiveness of Indian exporters. The uncertain macro-economic scenario and reduction in clothing volumes is also likely to put pricing pressure on the Indian exporters.

Working capital cycle to be elongated – The company's working capital cycle will remain elongated, given the slow consumer off-take through its own retail division, as the domestic business revives gradually. Further, collection cycle is expected to be longer for its exports business as overseas customers also go through strife in the current scenario.

Liquidity position- Adequate

The company has adequate liquidity in the near-term supported by cash and equivalents of Rs. 11.2 crore as on August 31 2020. The company also has investments in private equity funds of around Rs. 18 crore. Timely receipt on the investments would help support its liquidity. The company's bank limits utilisation is moderate at around 67% (sanctioned bank limit of Rs. 65.0 crore, primarily export packing credit) in the past six months. While the company has taken extension on some of its export packing credit facilities from banks, timely extension in future would be critical from a debt servicing perspective. The company is likely to incur capex of Rs. 8-10 crore in FY2021 for its factory in Bangladesh, which is expected to be funded from its existing cash balance in the UAE subsidiary. Furthermore, at a consolidated level, the company had Rs. 5.6 crore receivable as on March 31, 2020, from the sale of its UK subsidiary, which is expected to support the capital position of the company's overseas business. Though the promoters continue to support the company by way of unsecured loans, meaningful turnaround in operating performance across markets would be critical to support its liquidity position.

Rating sensitivities

Positive triggers – Sustained improvement in the company's operating performance leading to improved earnings and lower working capital intensity could trigger a positive rating movement.

Negative triggers – Downward pressure on ZCCL's rating could emerge if there is sustained pressure on its earnings and liquidity in the coming quarters due to slower consumer off-take across markets because of a weak demand environment. Further, any delay in infusion of funds by the promoters would also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Indian Textiles Industry - Apparels
Parent/Group Support	Not applicable
Consolidation/Standalone	The analysis is based on the consolidated financials of ZCCL with its subsidiary, Zodiac Clothing Co. S.A. (Switzerland), its step-down subsidiary, Zodiac Clothing Co. (UAE) LLC and Zodiac Clothing Bangladesh Limited.

About the company

Promoted by Mr. M.Y. Noorani, the House of Zodiac commenced operations as a partnership firm in 1954 for manufacturing neckties for men. 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 men's 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 1970s, 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 50% of its turnover (FY2020), while the domestic branded business drives the rest.

The branded business is mainly routed through two retail channels—exclusive brand outlets (EBOs) also referred to as own retail by ZCCL and multi-brand outlets (MBOs). The company supplies to MBOs across tier-I and II cities in the country. Its 114 EBOs (as on March 31, 2020) are mainly concentrated in tier-I cities, with the rest being spread across tier-II and III cities. ZCCL's manufacturing facilities are in Karnataka and Gujarat in India.

During Q1 FY2021, the company reported a net loss of 14.5 crore on a revenue of Rs. 11.9 crore compared to a revenue of Rs. 51.6 crore and a net loss of Rs. 13.5 crore during Q1 FY2020.

Key financial indicators

	FY2019	FY2020
	Audited	*Provisional
Operating Income (Rs. crore)	219.5	194.7
PAT (Rs. crore)	-26.8	-29.0
OPBDIT/OI (%)	-4.1%	5.8%
PAT/OI (%)	-12.2%	-14.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.7
Total Debt/OPBDIT (times)	-7.0	5.3
Interest Coverage (times)	-2.1	0.8

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

*FY2020 numbers are according to the IND-AS 116 standards and hence not comparable to FY2019 numbers.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

			Current Rating (FY2021)			Chronology of Rating History for the past 3 years			
						Date & Rating in FY2020		Date & Rating in FY2019	Date & Rating in FY2018
	Instrument	**Type**	**Amount Rated (Rs. crore)**	**Amount Outstanding (Rs. crore)**	**Date & Rating October 05, 2020**	**November 22, 2019**	**June 03, 2019**	**April 06, 2018**	**-**
1	Fund based facilities	Short Term	0.0	-	-	[ICRA]A2	Revised from [ICRA]A2+ to [ICRA]A2	Revised from [ICRA]A1 to [ICRA]A2+	
2	Non-fund based facilities	Short Term	0.0	-	-	[ICRA]A2	Revised from [ICRA]A2+ to [ICRA]A2	Revised from [ICRA]A1 to [ICRA]A2+	
3	Non-fund based/Fund-based	Short Term	65.0	-	Revised from [ICRA]A2 to [ICRA]A3+	-	-	-	
4	Commercial Paper	Short Term	-	-	-		-	Revised from [ICRA]A1 to [ICRA]A2+ and withdrawn	

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)	Rating and Outlook
NA	Short-term fund-based/non-fund based limits	-	NA	NA	65.00	[ICRA]A3+

Source: Zodiac Clothing Company Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Zodiac Clothing Co. S.A. (Switzerland)	100%	Full consolidation
Zodiac Clothing Co. (UAE) LLC	100%	Full consolidation
Zodiac Clothing Bangladesh Limited	100%	Full consolidation

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About ICRA Limited:

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