March 09, 2021

S.P. Apparels Limited: Ratings reaffirmed; Outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fun-based term loans	38.70	36.26	[ICRA]A+ reaffirmed; Outlook revised to Stable from Negative
Long term fund based working capital facilities (sub-limits)	(10.00)	(2.00)	[ICRA]A+ reaffirmed; Outlook revised to Stable from Negative
Short term fund based working capital facilities	192.50	201.00	[ICRA]A1 reaffirmed
Short term fund based working capital facilities (sub-limits)	(115.00)	(115.00)	[ICRA]A1 reaffirmed
Non-fund based working capital facilities	42.50	40.00	[ICRA]A1 reaffirmed
Unallocated facilities	3.60	0.04	[ICRA]A+/[ICRA]A1 reaffirmed; Outlook revised to Stable from Negative
Total	**277.30**	**277.30**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation and revision in outlook reflect the expected steady operational and financial performance of S.P. Apparels Limited (SPAL) in the coming quarters, supported by its established market position in the infantwear segment and strong relationship with large customers in the UK market. The ratings also consider SPAL's comfortable financial profile, characterised by a conservative capital structure with adequate coverage metrics and a comfortable liquidity position. While the operating performance of SPAL was adversely impacted in March 2020 and Q1 FY2021 because of the pandemic with a disruption in operations and deferment of orders, there has been a steady recovery in volumes in the recent quarters, which is expected to limit the overall decline in revenues in FY2021. ICRA expects SPAL's revenue decline to be around 20% in FY2021, also constrained by the operational issues like the social distancing norms and lack of adequate labour during a period of the year, limiting the capacity utilisation levels. A consistent growth in order inflows from existing large customers and addition of new customers are likely to drive a steady volume growth over the medium term, backed by its strong market presence in the infantwear segment. The company's operating profitability is expected to remain comfortable at around 15% in FY2021 despite a decline in revenues, supported by an improvement in operating efficiencies and the cost reduction measures taken. SPAL's operating margins are likely to be more than 15% in FY2022 but would remain exposed to the quantum of incentives made available to the industry under the proposed Remission of Duties or Taxes on Export Products (RoDTEP) scheme. While any reduction from the current levels would constrain margins, the impact is likely to be limited with the company expected to pass on a portion of the same to its customers as seen in the past. An improvement in performance over the recent quarters follows a period of moderation in revenues and earnings witnessed in FY2020, owing to loss of business from a few customers, a reduction in export incentives during the year (retrospective withdrawal of MEIS[1]) and a firm operating costs.

Despite a moderation in earnings witnessed in the recent fiscals (post the strong performance in FY2019), the credit metrics and liquidity position have remained comfortable and are expected to remain in line with the category medians, going forward. Key ratios including interest cover and net debt to operating profits for FY2021 are expected to be at around 6 times and 2 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

[1] *MEIS - Merchandise Exports from India Scheme*

medium term than adding new machines. Thus, with an expected improvement in earnings in FY2022, key credit metrics including the interest cover and the net debt to operating profits for FY2022 are estimated to be at around 8 times and 1.5 times, respectively. While the revenue concentration towards its large customers and key geographies remains high, with its top three customers contributing around 80% to the revenues, recurring orders received over the years provide some comfort. ICRA expects the concentration towards the top customers to reduce gradually over the medium term with the ongoing addition of new customers. While the order book has recovered in the recent quarters, it is expected to remain sensitive to any future disruptions in business because of any pandemic-related demand pressure in key markets over the near term. 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, continued weak performance in the domestic retail segment 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, featuring among the large 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 over the medium term.

Comfortable financial profile – Stable 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 despite the weak earnings in Q1 FY2021. Key ratios including the gearing and the net debt to operating profits were at 0.4 times and 2.3 times, respectively in H1 FY2021.

Credit challenges

Customer concentration risk remains high; widening client base mitigates the risk to some extent – The company's top three customers contributed ~80% to its export revenues in FY2020 and H1 FY2021. 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, and the recent addition of new customers. The fact that some of the recently added customers have contributed around 10% to the revenues in FY2020 and SPAL's continued steps to further diversify its revenue base provide comfort.

Earnings exposed to fluctuations in input prices and incentive structure – The operating profitability of SPAL is exposed to volatility in cotton and yarn prices, as it has relatively limited pricing flexibility with large customers. 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. Further, profitability of exporters remains dependent on the export incentives, reduction of which with retrospective effect had dented SPAL's margins in FY2020 by around 400 bps. Nevertheless, SPAL's ability to improve its operating efficiencies and reduce costs to support recovery in margins in the recent quarters despite lower export incentives and losses in the domestic retail segment lend comfort.

Liquidity position: Adequate

SPAL's liquidity position is expected to remain adequate to meet its funding requirements, supported by expected steady earnings and adequate unutilised lines of credit. Free cash and bank balances and the buffer available in working capital limits utilised together stood at around Rs. 90 crore as on January 31, 2021 against limited capital expenditure requirements and debt repayment obligations of around Rs. 10 crore over the next 12 months. The average working capital utilisation stood at around 65% in the last 12 months. Despite the high working capital funding requirements in the business, the liquidity position is expected to remain comfortable, supported by the consistent earnings in operations, cash reserves held and large unutilised lines of credit.

Rating sensitivities

Positive factors – SPAL's ratings may be upgraded if its scale of operations and earnings register a steady growth on a sustained basis, consequently strengthening its credit metrics and liquidity position, and its business profile becomes more diversified with addition of new customers across geographies. Key metrics which may result in an upgrade include net debt to operating profits reducing to less than 1.0 times on a sustained basis.

Negative factors – Pressure on SPAL's ratings may emerge if there is a sustained pressure on revenues and earnings in the coming quarters, or if there is an elongation in its working capital cycle, which would adversely impact its credit metrics and liquidity position. Specific metrics, which may result in a downgrade include the interest cover reducing to below 5 times, or the net debt to operating profits increasing to more than 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Apparel Manufacturers
Parent/Group Support	NA
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financial profile of SPAL. Details of the consolidated subsidiaries are given 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 in November 2005 as a public limited company, SPAL was listed on both the Bombay Stock Exchange and the National Stock Exchange in August 2016. SPAL's manufacturing facilities are located 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 (audited)

S.P. Apparels Consolidated	FY2019	FY2020
Operating Income (Rs. crore)	824.7	815.6
PAT (Rs. crore)	134.2	88.5
OPBDITA/OI (%)	16.3%	10.8%
PAT/OI (%)	8.7%	5.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	0.7
Total Debt/OPBDITA (times)	1.6	2.2
Interest Coverage (times)	8.8	5.8

Source: SPAL

PAT: Profit after Tax; OPBDITA: 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 (FY2021)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated	Amount Outstanding	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019		Date & Rating in FY2018
					March 9, 2021	April 24, 2020	July 1, 2019	Jan 7, 2019	July 6, 2018	Jun 29, 2017
1	Term Loans	Long Term	36.26	28.66*	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)
2	Fund-based (sub-limits)	Long Term	(2.00)	-	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	[ICRA]A (Stable)
3	Fund based	Short Term	201.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
4	Fund based (sub-limit)	Short Term	(115.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
5	Non-fund-based limits	Short Term	40.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-
6	Unallocated limits	Long / Short Term	0.04	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	-	[ICRA]A (Stable)/ [ICRA]A1

Source: SPAL; term loans outstanding as on September 30, 2020

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 Sanction	Coupon Rate	Maturity Date	Amount Rated	Current Rating and Outlook
NA	Term Loan 1	Apr-17	-	Mar-23	3.45	[ICRA]A+(Stable)
NA	Term Loan 2	Jul-18	-	Mar-23	1.38	[ICRA]A+(Stable)
NA	Term Loan 3	Jul-18	-	Mar-24	5.24	[ICRA]A+(Stable)
NA	Term Loan 4	Jan-19	-	Mar-24	6.83	[ICRA]A+(Stable)
NA	Term Loan 5	Feb-20	-	Sep-25	2.28	[ICRA]A+(Stable)
NA	Term Loan 6	Jul-18	-	Mar-24	8.58	[ICRA]A+(Stable)
NA	Term Loan 7	Jun-20	-	Mar-26	8.50	[ICRA]A+(Stable)
NA	Long term fund based (sub-limits)	-	-	-	(2.00)	[ICRA]A+(Stable)
NA	Short term fund bases limits	-	-	-	201.00	[ICRA]A1
NA	Short term fund based (sub-limits)	-	-	-	(115.00)	[ICRA]A1
NA	Non-fund-based limits	-	-	-	40.00	[ICRA]A1
NA	Unallocated limits	-	-	-	0.04	[ICRA]A+(Stable) / [ICRA]A1

Source: SPAL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Crocodile Products Private Limited	70%	Full Consolidation
S. P. Apparels (UK) (P) Limited	100%	Full Consolidation

Source: SPAL

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Balaji M
+91 44 4596 4317
balaji.m@icraindia.com

Athira Jayakumar
+91 44 4596 4300
athira.jayakumar@icraindia.com

Prateek Pasari
+91 40 4067 6517
prateek.pasari@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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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ICRA Limited

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches