

March 30, 2017

## Zodiac Clothing Company Limited

	Amount	Rating Action
	In Rs. Crore	
Short-term, Fund-based limits	70.0	[ICRA]A1 revised from [ICRA]A1+
Short-term, non-fund based facilities	10.0	[ICRA]A1 revised from [ICRA]A1+
Commercial Paper	20.0	[ICRA]A1 revised from [ICRA]A1+

\*Instrument Details are provided in Annexure-1

### Rating Action

ICRA has revised the short-term rating on the Rs. 70.0 crore<sup>1</sup> short-term fund based and Rs. 10.0 crore non-fund-based facilities of Zodiac Clothing Company Limited (ZCCL) to [ICRA]A1 (pronounced ICRA A one) from [ICRA]A1+ (pronounced ICRA A one Plus)<sup>2</sup>. ICRA has also revised the rating on the Rs.20.0 crore Commercial Paper programme of ZCCL to [ICRA]A1 from [ICRA]A1+.

### Rationale

The rating revision factors in the continued weak business and financial performance during 9M FY2017 reflected in the y-o-y decline in consolidated revenues and operating loss during the period. The export business declined significantly during 9M FY2017 because of weak consumer off-take in the key markets of the US, the UK and Middle East. Furthermore, the domestic business remained subdued on account of overall weak consumer sentiments, high competitive intensity and demonetisation which impacted revenues during November and December 2016. The y-o-y decline in revenues resulted in under-absorption of fixed costs, and consequently in operating loss. ICRA expects pressure on operating profitability to continue, given the tough operating environment especially in the domestic market.

Nevertheless, the rating continues to factor in the extensive experience of the promoters of ZCCL in the readymade garments business; its professional management team and adequate financial flexibility backed by low gearing and strategic investment, with a market value significantly in excess of the book value. The rating continues to draw comfort from its stringent receivables policy—low debtor days and comfortable capital structure (consolidated gearing of 0.29 time as on December 31, 2016). ICRA expects the company's liquidity position to be supported by sale of its listed investments as and when required. The sale of its second level subsidiary holding properties in the UK for a consideration of AED 1.8 million (approximately Rs. 33.0 crore) could help support 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 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.

Though the operating performance is expected to remain under pressure on account of the difficult operating and economic environment, the company's efforts towards enhancing its liquidity in the near-term through various measures, including leasing out its manufacturing facility at Dubai and liquidating its listed investments, will be crucial. Additionally, turn around in business and financial performance during subsequent quarters will be a critical monitorable.

<sup>1</sup> Rs. 100 lakh = Rs. 1 crore = Rs. 10 million

<sup>2</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

## Key rating drivers

### Credit Strengths

- Established brand name in the domestic markets with focus on the premium segment through its branded business (Zodiac, ZOD! And Z3)
- Strong design focus in exports business and established customer base
- Financial flexibility on the back of low gearing, strategic investments having market value significantly in excess of book value; divestment of property subsidiary in 9MFY17 to support overseas working capital requirements

### Credit Weakness

- EBITDA loss in 9M FY2017 as on account of lower volumes in domestic markets and export markets leading to under absorption of fixed costs; margin rebound dependant entirely on demand pickup across markets
- High competitive intensity in the domestic market
- Working capital position could remain high given the slow off-take through own retail

### Description of key rating drivers highlighted above:

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. Additionally, the company has an established track record and long relationship in the exports business backed by its in-house designing capabilities. In order to support export sales, the company has started focusing on widening its customer base and have added a few customers in Europe. ICRA has factored in the steady rental income from real estate investments and sale of strategic investment in listed entity which provides liquidity comfort since cash generation from core business remains weak. Further, sale of its 2<sup>nd</sup> level subsidiary, Zodiac Properties, holding its two properties in the UK is expected to support funding of overseas working capital.

With declining volumes in both domestic and export markets, the company reported a sharp de-growth in consolidated operating income during 9M FY2017 which led to under absorption of overhead costs and operating loss (EBITDA of -4.0%). For the domestic business, the intense competition from other premium brands and incessant discounting by them continues to impede the top line and profitability for ZCCL's domestic business since its brands are not discounted. Also, in the past three years, rampant discounting by ecommerce companies on electronic goods and clothing merchandise has resulted in share of wallet being lost to them thus impacting revenues for ZCCL's domestic branded business. Further, inventory days were higher as on December 31, 2016 given the reduction in sales velocity post demonetisation. The margin rebound depends entirely on the volume recovery in both domestic and exports segments; also with the domestic business having high operating leverage revenue growth there shall be crucial in turning around the financial performance.

**Analytical approach:****Links to applicable Criteria**

- » Rating Methodology for Retail Industry
- » Rating Methodology for 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 48% of its turnover (9M 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 138 EBOs (as on December 31, 2016) 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 located in Karnataka and Gujarat in India

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History for last three years:**
**Table: Rating History**

S No	Name of the instrument	Current Rating			Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month-year & Rating in FY2017	Month-year & Rating in FY2016	Month-year & Rating in FY2015	Month-year & Rating in FY2014
				<b>Mar-17</b>	<b>Aug-16</b>	<b>Jul-15</b>	<b>Apr-14</b>	<b>May-13</b>
1	Fund-based limits	Short-term	70.0	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Non-fund based facilities	Short-term	10.0	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Commercial Paper	Short-term	20.0	[ICRA]A1	[ICRA]A1+	[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](http://www.icra.in) **Annexure-1**

**Details of Instrument**

<b>Name of the instrument</b>	<b>Date of issuance</b>	<b>Coupon rate</b>	<b>Maturity Date</b>	<b>Size of the issue (Rs crore)</b>	<b>Current Rating and Outlook</b>
Fund-based limits	-	-	Repayable on demand	70.0	[ICRA]A1
Non-fund based facilities	-	-	Repayable on demand	10.0	[ICRA]A1
Commercial Paper	Not placed	-	Not applicable	20.0	[ICRA]A1

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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.

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