S.P. Apparels Limited

January 07, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loans	33.30	41.23	[ICRA]A+(Stable); assigned/outstanding
Long-term fund-based working capital facilities (sub-limits)	0.00	(10.00)	[ICRA]A+(Stable); assigned
Short-term fund-based working capital facilities	150.00	180.00	[ICRA]A1; assigned/outstanding
Short-term fund-based working capital facilities (sub-limits)	(20.00)	(115.00)	[ICRA]A1; assigned/outstanding
Non-fund based working capital facilities	0.00	40.00	[ICRA]A1; assigned
Unallocated facilities	0.00	16.07	[ICRA]A+(Stable)/ [ICRA]A1; assigned
Total	**183.3**	**277.3**	

*Instrument details are provided in Annexure-1

Rationale

The assigned ratings reflect the consistent operational and financial performance of SP Apparels Limited (SPAL) during recent quarters, and the expected improvement in earnings and capitalisation ratios over the medium term. SPAL's established market position in the infant wear export segment, strong relationship with a reputed clientele aiding in recurring order inflow and growing supplies to new customers have supported volume and revenue growth in H1 FY2019. With improving customer and geographical mix and healthy growth in orders received from existing customers as evident from the current order book position, volumes of SPAL are expected to register a revenue growth of more than 12% in H2 FY2019 and FY2020. Operating margins (OPM) remain supported by its strong operating efficiency and improving economies of scale. OPM levels are expected to remain healthy at ~18% over the medium term. The ratings also take comfort from the comfortable financial profile of SPAL, characterised by conservative capital structure, adequate coverage metrics and stable liquidity position. Key ratios including Total Debt to operating profits and Interest Coverage are likely to remain comfortable at around 1.6 times and 7.3 times respectively in FY2020. The same is despite the ongoing capital expenditure plans towards capacity expansion to the tune of Rs. 150-160 crore combined in FY2019 and FY2020 and high working capital requirements in the business. The ratings continue to factor in the company's high revenue concentration towards its top three customers. Nevertheless, revenues from new customers have increased in recent quarters and with the proposed addition of other large retailers, concentration towards top three customers is expected to reduce to ~70% by FY2020. The company is also exposed to external factors, such as foreign exchange fluctuations, regulations and duty structures across markets. Besides, the ratings consider the increasing pricing pressure that exposes earnings to fluctuations in input prices, moderate performance in the domestic retail segment due to intense competition and the high working capital intensity inherent in the business. Despite these concerns, SPAL's operational strengths including its established presence and integrated nature of operations with strong manufacturing capabilities are likely to drive revenue growth and earnings over the medium term.

Outlook: Stable

ICRA believes that SPAL will continue to benefit from its growing customer base and ongoing capacity additions. The outlook may be revised to Positive if revenues and earnings significantly exceed estimates and further strengthen the financial risk profile. The outlook may be revised to Negative if there is any sharp reduction in earnings, or if there is any major debt-funded expenditure which would result in deterioration in capital structure and debt coverage indicators.

Key rating drivers

Credit strengths

Established market presence and strong customer base – SPAL is a leading manufacturer and exporter of childrenswear, featuring among the larger organised exporters in the category. The company predominantly caters to the infant wear segment and derives a major portion of its revenues from the relatively high margin value-added products. SPAL exports to leading retailers and enjoys long-standing relationships with its customers.

Integrated nature of operations– SPAL enjoys integrated manufacturing facilities with presence across spinning, knitting, processing (dyeing), garmenting (sewing), printing, and embroidery. The company is in the process of further enhancing its backward process capacities and debottlenecking and modernising its existing capacities. These steps would aid SPAL in reducing its external dependence for materials, resulting in better efficiencies and margins.

Comfortable financial profile – Steady earnings from operations and funds raised through the Initial Public Offering in FY2017 have supported SPAL's financial profile, despite continuous capacity expansion undertaken and moderately high working capital intensity. The same is evident from key ratios including gearing, total debt to operating profits and debt service coverage ratio at 0.4 times, 1.4 times and 4.0 times respectively for H1 FY2019. Despite the proposed expenditure, steady earnings and adequate cash reserves are expected to support the credit profile of SPAL.

Credit weaknesses

Customer concentration risk remains high; offset to an extent by the widening client base – As discussed earlier, the company's top three customers continue to contribute to more than 75% of export revenues. Thus, the revenues and earnings of SPAL are exposed to vagaries in performance of its key customers, apart from other external factors such as regulations and duty structures across markets. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, and the recent addition of new customers.

Earnings exposed to fluctuations in input prices – The Operating profitability of SPAL is exposed to volatility in cotton and yarn prices, with relatively limited pricing flexibility enjoyed 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, SPAL's ability to report stable operating margins during the last three fiscals provide comfort despite reduction in export incentives and modest margins witnessed in the domestic retail segment.

Liquidity Position

SPAL's liquidity profile remains comfortable, supported by the cash and liquid investments held (Rs. 76 crore as on September 30, 2018) and adequate unutilised lines of credit. Despite the ongoing capital expenditure, healthy earnings with expected cash accruals of more than Rs. 80 crore per annum over the medium term, cash reserves held and low repayment obligations of about Rs. 35 crore during the period FY2019-FY2021 are likely to support the cash flow position of SPAL over the medium term.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities operating in the Apparel Industry
Parent/Group Support	NA
Consolidation	For arriving at the ratings, ICRA has considered the consolidated financial profile of SPAL with details of the subsidiaries consolidated given in annexure 2

About the company:

Located close to the textile hub of Tirupur in Tamil Nadu, SPAL produces 100% knitted cotton ready-made 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. It entered the domestic retail market in FY2007 by acquiring a 70% equity stake in Crocodile Products Private Limited, the Indian arm of the Singapore-based Crocodile International Private Limited (which markets the menswear brand, Crocodile). SPAL manufactures and markets apparels under the Crocodile brand and trades in essentials in the domestic market.

Key financial indicators (audited and consolidated)

Particulars (in Rs. crore)		Consolidated	
Fiscal	FY2017	FY2018	H1 FY2019
Operating Income (Rs. crore)	649.7	673.3	381.6
PAT (Rs. crore)	53.6	47.8	27.5
OPBDIT/OI (%)	18.7%	18.4%	17.8%
RoCE (%)	22.5%	15.0%	15.3%
Total Debt/TNW (times)	0.5	0.6	0.4
Total Debt/OPBDIT (times)	1.5	1.8	1.4
Interest coverage (times)	5.4	6.7	9.4

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					Jan 2019	Jul 2018	Jun 2017	Sep 2016	Sep 2015
1	Term Loans	Long Term	41.23	18.02*	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BB (Stable)
2	Fund-based (sub-limits)	Long Term	(10.00)	-	[ICRA]A+ (Stable)	-	[ICRA]A (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BB (Stable)
3	Fund-Based Limits	Short Term	180.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2	[ICRA]A4
4	Fund-based (sub-limits)	Short Term	(115.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2	-
5	Non-fund based Limits	Short Term	40.00	-	[ICRA]A1	-	-	-	-
6	Unallocated limits	LT/ST term	16.07	-	[ICRA]A+ (Stable)/ [ICRA]A1	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	-

**Outstanding as on September 30, 2018; Source: SPAL*

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 (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	April 2015	-	Dec 2020	1.60	[ICRA]A+(Stable)
NA	Term Loan 2	Feb 2017	-	March 2023	7.12	[ICRA]A+(Stable)
NA	Term Loan 3	Nov 2017	-	March 2023	2.61	[ICRA]A+(Stable)
NA	Term Loan 4	June 2018	-	March 2024	7.50	[ICRA]A+(Stable)
NA	Term Loan 5	June 2018	-	March 2024	12.50	[ICRA]A+(Stable)
NA	Term Loan 6	Oct 2018	-	Not availed	9.90	[ICRA]A+(Stable)
NA	Long-term fund-based (sub-limits)	-	-	-	(10.00)	[ICRA]A+(Stable)
NA	Short-term fund-based Limits	-	-	-	180.00	[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	-	-	-	16.07	[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

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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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