April 24, 2020

S.P. Apparels Limited: Ratings re-affirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loans	38.70	38.70	[ICRA]A+ reaffirmed; long-term outlook revised to Negative from Stable
Long-term fund-based working capital facilities (sub-limits)	(10.00)	(10.00)	[ICRA]A+ reaffirmed; long-term outlook revised to Negative from Stable
Short-term fund-based working capital facilities	192.50	192.50	[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	42.50	[ICRA]A1; reaffirmed
Unallocated facilities	3.60	3.60	[ICRA]A+/ [ICRA]A1 reaffirmed; long-term outlook revised to Negative from Stable
Total	**277.30**	**277.30**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook on the long-term rating of S.P. Apparels Limited (SPAL) is in line with ICRA's negative outlook for the apparel sector. The operating performance of SPAL is expected to be under pressure in the near term, given the adverse impact on demand conditions seen in key markets following the outbreak of Covid-19. Sales volumes from the last week of March 2020 were impacted owing to postponement of orders from key customers and the nationwide lockdown imposed in India. The apparel segment is expected to be more vulnerable, given its sensitivity to consumer demand and sentiment, as well as the labour-intensive nature of operations. The strength of the recovery will be contingent on the duration and extent of the Covid-19 pandemic, where a prolonged downturn in apparel demand will constrain revenues and earnings. While the infantwear segment is not immune to the expected contraction in consumer spending, demand in this niche segment is expected to be relatively more resilient compared to the other apparel product categories. While garment exporters are expected to witness a revenue decline of around 20% in FY2021, decline for the infantwear players, including SPAL, is likely to be lower than the same. For apparel exporters, weak global demand conditions are also likely to result in an elongation of receivables cycle and some inventory build-up in the coming months. However, SPAL's liquidity position remains comfortable, which is expected to aid in tiding over the near-term increase in funding requirements. Against this backdrop, ICRA will continue to monitor the developments and take appropriate rating action when necessary.

The company's operating performance was largely stable during the major part of FY2020, supported by a steady demand from key customers. However, overall revenues and earnings were lower than earlier expectations owing to loss of business from few customers and reduction in export incentives during the year. Despite lower earnings, the credit metrics and liquidity position 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 FY2020 are estimated to be at around 8 times and 1.3 times, respectively. The ratings continue to derive comfort from the established market position in the infantwear export segment and strong relationship with a reputed customer base, aiding in recurring order inflow. While the revenue concentration towards its large customers and key geographies remains high, with its top four customers contributing around 80% to the revenues, recurring orders received over the years provide some comfort. ICRA expects the concentration towards top four customers to reduce gradually over the medium term with the proposed addition of new customers. 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 increasing pricing pressure that exposes earnings to fluctuations in input prices, continued weak performance in the domestic retail segment due to intense competition and the high working capital intensity inherent in the business.

SPAL is seeking a moratorium on payments from its lenders as a part of the Covid-19 regulatory package announced by the Reserve Bank of India (RBI) on March 27, 2020. Accordingly, some of the scheduled payment obligations were deferred as on March 31, 2020, in anticipation of formal approval from the lenders. Despite the missed payment and the absence of a formal approval from the lenders allowing for a payment relief, ICRA has not recognised this instance as a default as of now. This is based on ICRA's expectation that a formal approval for rescheduling the loan would be received soon, as permitted by the RBI as a part of the relief measures announced recently. Non-recognition of default in this case is as per the guidance provided by the SEBI circular number SEBI/HO/MIRSD/CRADT/CIR/P/2020/53 dated March 30, 2020. However, it may be noted that if the lenders do not approve of the moratorium in due course, ICRA would review the above stance on default recognition.

Key rating drivers

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 recently expanded its backward process capacities and completed debottlenecking and modernising its existing capacities, which are expected to improve value addition and operating efficiency over the medium term.

Comfortable financial profile – Stable earnings from operations in the recent fiscals 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 key ratios including gearing and total debt to operating profits, which are estimated to be at 0.3 times and 1.3 times, respectively for FY2020.

Credit challenges

Expected moderation in operating performance in the near term – In line with the industry, SPAL's revenues and earnings are expected to be adversely impacted in Q1 FY2021, owing to the prevalent tepid demand conditions given the

Covid-19 outbreak. This, in turn, is likely to result in moderation in coverage metrics and liquidity position during H1 FY2021.

High customer concentration risk and limited pricing flexibility – The company's top four customers contribute ~80% to its export revenues. Thus, revenues and earnings of SPAL depend on the performance of its key customers, apart from other external factors such as regulations and duty structures across the markets. The risk is mitigated to an extent by the established relationship enjoyed with its clientele and continued customer addition by the company. The operating profitability of SPAL is exposed to volatility in cotton and yarn prices, as it has limited pricing flexibility with large customers. Its 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.

Liquidity position: Adequate

SPAL's liquidity position is expected to remain adequate to meet its rising funding requirements, supported by free cash and bank balances and the buffer available in working capital limits utilised, which together stood at around Rs. 90 crore as on March 31, 2020. The average working capital utilisation was at around 75% during the year. While the liquidity buffer is likely to moderate in the near term with expected losses from operations in Q1 FY2021, a subsequent likely growth in earnings and the measures undertaken by the company to rationalise its costs and reduce its working capital cycle are expected to support its liquidity position.

Rating sensitivities

Positive triggers – Given the Negative outlook, an upgrade in the ratings is unlikely in the near term. However, the outlook may be revised to Stable if there is a strong recovery in volumes and earnings in the coming quarters and if the working capital intensity reduces, which would consequently result in comfortable credit metrics and liquidity position.

Negative triggers – 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 interest cover lower than 5 times on a sustained basis, or net debt to operating profits 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	For arriving at the ratings, ICRA has considered the consolidated financial profile of SPAL. Details of the subsidiaries, consolidated, 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. 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 (Consolidated- audited)

Fiscal	FY2018	FY2019
Operating Income (Rs. crore)	673.3	826.4
PAT (Rs. crore)	47.8	71.7
OPBDIT/ OI (%)	18.4%	16.4%
RoCE (%)	15.0%	19.2%
Total Outside Liabilities/ Tangible Net Worth (times)	1.1	0.9
Total Debt/ OPBDITA (times)	1.8	1.6
Interest coverage (times)	6.7	8.9
DSCR	3.0	5.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument		Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 24- April 2020	Date & Rating in FY2020 1-Jul-2019	Date & Rating in FY2019 7-Jan-2019	Date & Rating in FY2019 6-Jul-2018	Date & Rating in FY2018 29-Jun-2017
1	Term Loans	Long Term	38.70	31.90*	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)
2	Fund-based (sub-limits)	Long Term	(10.00)	-	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	[ICRA]A (Stable)
3	Fund-Based Limits	Short Term	192.50	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
4	Fund-based (sub-limits)	Short Term	(115.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
5	Non-fund based Limits	Short Term	42.50	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-
6	Unallocated limits	LT/ST term	3.60	-	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1	-	[ICRA]A (Stable)/ [ICRA]A1

**Outstanding as on May 31, 2019; 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	0.90	[ICRA]A+(Negative)
NA	Term Loan 2	Feb 2017	-	March 2023	5.32	[ICRA]A+(Negative)
NA	Term Loan 3	Nov 2017	-	March 2023	2.58	[ICRA]A+(Negative)
NA	Term Loan 4	June 2018	-	March 2024	7.50	[ICRA]A+(Negative)
NA	Term Loan 5	June 2018	-	March 2024	12.50	[ICRA]A+(Negative)
NA	Term Loan 6	Oct 2018	-	Not availed	9.90	[ICRA]A+(Negative)
NA	Long-term fund-based (sub-limits)	-	-	-	(10.00)	[ICRA]A+(Negative)
NA	Short-term fund-based Limits	-	-	-	192.50	[ICRA]A1
NA	Short term fund-based (sub-limits)	-	-	-	(115.00)	[ICRA]A1
NA	Non-fund based Limits	-	-	-	42.50	[ICRA]A1
NA	Unallocated limits	-	-	-	3.60	[ICRA]A+(Negative)/[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

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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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For more information, visit www.icra.in

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