# Zodiac Clothing Company Limited

October 11, 2021

**Ratings**

| Facilities | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long Term Bank Facilities | 54.00 | CARE BB+; Positive (Double B Plus; Outlook: Positive) | Assigned |
| Total Facilities | 54.00 (Rs. Fifty-Four Crore Only) | | |

*Details of instruments/facilities in Annexure-1*

**Detailed Rationale & Key Rating Drivers**

The ratings assigned to the bank facilities of Zodiac Clothing Limited (ZCCL) continue to derive strength from the long track record and established brand presence of the company in the men's wear segment supported by wide geographical presence. The ratings take note of comfortable capital structure and adequate liquidity profile of the company. Additionally, the ratings also factor in promoter's experience in the apparel segment and the financial support extended to the company.

The rating strengths, however, are tempered by the significant decline in scale of operations over the years leading to net losses and elongated working capital cycle. The operations in FY21 and Q1FY22 continue to be significantly impacted by COVID-19 related restrictions. With intense competition from both organised and unorganised players in the industry, the company has limited pricing flexibility.

Going forward, CARE expects, with uptick in exports and various cost rationalisation measures, PBILDT margins to expand along with the scale of operations. The same continues to remain key rating monitorable.

**Rating Sensitivities**

**Positive Factors - Factors that could lead to positive rating action/upgrade**

- Increase its scale of operations with total operating income beyond Rs. 200 crore through volume driven growth on a sustained basis.
- Improvement in its PBILDT margin to around 20% on sustained basis.
- Improvement in its operating cycle to below 180 days on a sustained basis.

**Negative Factors - Factors that could lead to negative rating action/downgrade**

- Pressure on revenues and earnings resulting in PBILDT margin less than 10% resulting in net loss.
- Deterioration in its overall gearing to over 0.75x and Total debt to Gross Cash Accruals (TDGCA) of more than 5x on sustained basis.
- Reduction in free cash & cash equivalents below Rs. 10 crore.

**Outlook: Positive**

The 'Positive' outlook has been assigned on the expectation of increase in its scale of operations along with improvement in its operating profitability (PBILDT margin). The outlook may be revised to 'Stable' in case of lower-than-expected growth in sales and/or profitability margin and reduce operating cycle.

**Detailed description of the key rating drivers**

**Key Rating Weakness**

**Declining scale of operations further impacted due to COVID19 pandemic in FY21**

Scale of ZCCL's operations have been declining at from FY14 onwards. The fall in TOI is on account of declining off-take in key export markets, subdued consumer sentiments, increased domestic competition, aggravated by the outbreak of COVID19. The company has been facing intense competition from low cost countries such as Bangladesh and Vietnam in its export segment.

ZCCL has a policy of non-discounting, the company has end of season sale only once a year whereas most other brands have off-season sales twice a year. This has restricted company's growth in terms of footfalls and resulted in shrinking customer base. Further, the company has been closing non-performing stores due to increased competition in domestic apparel segment from bigger domestic as well as international brands.

ZCCL's operations were further marred with the outbreak of the COVID19 pandemic which led to company reporting net loss of Rs. 29.38 crore on total income of Rs. 126.01 crore in FY21.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

**Deteriorating working capital cycle**

Widespread dealers, EBOs and exports necessitates holding large inventory to cater to assortment of product demand from the distribution network resulting in high inventory days and consequently elongated working capital cycle. ZCCL's working capital cycle has elongated from 110 days in FY18 to 274 days in FY21. The same is on account of increase in inventory period from 116 days in FY18 to 275 days in FY21.

As indicated by the management, the focus has been on liquidating the inventory which has built up over that last 2 years.

ZCCL as on June 30, 2021 has Rs. 25.08 crore receivable from the government towards GST refund, income tax refund and export incentive receivables. The management expects liquidation of inventory and clearing of receivables from the government to aid in improving the liquidity profile of the company.

**Foreign currency fluctuation risk**

As on March 31, 2021; total foreign exchange earnings stood at Rs. 64.47 crore against Rs. 14.54 crore of foreign exchange outgo. Hence, ZCCL is a net exporter. The company follows a hedging policy wherein it hedges close to 100% of booked exposure due within 1 year and 25% due within 1+ years. ZCCL's hedging policy helps it to mitigate risk to that extent. Ability of the company to successfully manage its foreign exchange fluctuation risk remains critical from the credit perspective. ZCCL in FY21 made forex gain of 0.27 crore and Rs. 0.92 crore in FY20.

**High competition in exports and fashion retail**

ZCCL faces high degree of competition in export markets from low cost producer countries such as Vietnam and Bangladesh among others. These countries have emerged as India's competitors owing to their Lease Developed Country status or effective trade agreements.

The company also faces intense competition in domestic markets from large and established brick and mortal retailers along with e-commerce players like Amazon, Flipkart, Myntra.

**Uncertainty about third wave of COVID**

The company's retail operations continue to remain impacted on account of COVID induced restrictions which are localised to various states. Sales and profitability are expected to remain impacted in FY22, although not as significant as in FY21. Uncertainty regarding the third wave of COVID might lead to curtailed discretionary spending and slow economic recovery.

**Key Rating Strengths**

***Moderation in sales and profitability of the company***

**Long track record of operations, significant experience of promoter and fund support**

Founded by Late Mr. M. Y. Noorani, the promoters of the company have experience of more than five decades in textiles and apparels business. The business is currently led by an able management team headed by Mr. A. Y. Noorani and Mr. S. Y. Noorani, sons of the late founder. The company over the years has expanded its reach in both domestic as well as international markets to become one of the leading players in branded men's wear.

The promoters have also demonstrated support towards growth of the company and have regularly infused funds to support loss making operations. The company raised Rs. 50 crore in FY19 and FY20 through preferential allotment of equity shares to the promoters. Further, the promoters also infused Rs. 16.72 crore in FY20 through unsecured loans. During Q4FY21, the unsecured loans were converted to equity and additional Rs. 8.13 crore were infused in the company through equity.

**Established brand presence and diversified product portfolio**

ZCCL over the years has broadened its product portfolio, which now spans across formal wear, club wear and casual wear through its brands Zodiac, ZOD! and Z3. The company through its brands operates primarily in the premium segment.

The company manufactures and exports products for marquee brands like Zara, Guess, Liverpool and others. 90% of the company's exports is to USA and European countries and the balance is to Middle East.

**Diversified geographical presence**

ZCCL has diversified geographical presence across India and across the globe. The company has good relationship with its clients in the exports business which are spread across USA, Europe and Middle East. Exports, which usually form over 50% of ZCCL's revenues, increased to 63.04% in FY21 on account of nationwide lockdown and restrictions in operating shops and stores in malls in domestic markets. The company is looking to establish a manufacturing facility in Bangladesh and a company in USA to further improve its reach

On the domestic front, ZCCL generates revenues through its channel partners like EBOs (60%), dealers (22%), web store (13%) and institutional clients (5%) like banks, airlines, etc. The company currently has presence in over 40 cities and operates 60,000sft of retail space through 116 stores.

**Comfortable capital structure; limited reliance on external debt despite losses**
ZCCL's capital structure is characterised by comfortable overall gearing ratio of 0.35x as on March 31, 2021 as against 0.55x as on March 31, 2020. Despite reporting losses at net levels since FY16, ZCCL has restricted its reliance on external debt. The company's operations have been supported through infusion of equity aggregating to Rs. 50 crore over FY19 and FY20. The promoters further infused Rs. 16.72 crore towards the end of FY20 through unsecured loans. During Q4FY21, the converted the unsecured loans were converted to equity and additional Rs. 8.13 crore was infused by the promoters.

**Liquidity: Adequate**
ZCCL has adequate liquidity in the form of investment in mutual funds to the tune of Rs. 10.98 crore as on August 31, 2021 and through holding of 2.21 lakh equity shares of Shoppers Stop Limited (SSL) valued at Rs. 5.41 crore (as on September 24, 2021). Although average working capital utilisation for last 12 months ended Aug-21 remains on the higher side at 73.01% (sanctioned limit: Rs. 45 crore), the company has some headroom available along with estimated GCA of Rs. 34.03 crore in FY22. ZCCL has adequate cushion against scheduled debt repayments aggregating to Rs. 2.77 crore in FY22.
Apart from the above liquid investments and shares of SSL, ZCCL also has investments in venture capital funds such as Faering Capital, Paragon Partners and Tata Capital amounting to Rs. 23.23 crore as on August 31, 2021. As on August 30, 2021, ZCCL has unencumbered cash and bank balance of Rs. 0.50 crore and unencumbered investments (liquid and venture capital) of Rs. 33.71 crore.

**Analytical Approach:** Consolidated. The list of subsidiaries considered for consolidation is listed as Annexure 5

**Applicable Criteria**
Policy in respect of Non-cooperation by issuer
Policy on default recognition
Consolidation
Financial Ratios – Non-financial Sector
Cotton Textile
Manufacturing Companies

**About the Company**
Mr. M. Y. Noorani, the promoter of ZCCL, initially started the venture the House of Zodiac as a partnership firm in 1954, manufacturing neckties for men. The entity started exporting its products from 1960s and entered branded shirt business catering to the premium segment in 1970s. ZCCL was incorporated in 1984 and is currently operating 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". These brands are licensed by ZCCL from its group company, Metropolitan Trading Company (MTC), a partnership firm that is 100% owned by the promoters under a perpetual licensing arrangement. MTC charges a royalty of 1% over the annual turnover from ZCCL. The readymade garments export business accounts for over 60% of its turnover (FY21). The domestic branded business is mainly routed through exclusive brand outlets (EBOs) and multi-brand outlets (MBOs). Its 102 operational EBOs present in over 40 cities (as on March 31, 2021) are mainly concentrated in tier-I cities, with the rest being spread across tier-II and III cities. ZCCL is engaged in cutting, stitching, washing, and pressing of fabric into apparels at its manufacturing facilities are located at Bengaluru, Karnataka and Umbergaon, Gujarat in India.

| Brief Financials (Rs. crore) | FY20 (A) | FY21 (A) | Q1FY22 |
|---|---|---|---|
| Total operating income | 322.43 | 211.30 | 24.90 |
| PBILDT | 32.28 | 14.21 | -1.19 |
| PAT | 18.54 | 5.93 | -7.81 |
| Overall gearing (times) | 0.07 | 0.01 | NA |
| Interest coverage (times) | 12.32 | 9.61 | NM |

*A: Audited; NA: Not Available; NM: Not Meaningful*

**Status of non-cooperation with previous CRA:** Not Applicable
**Any other information:** Not Applicable
**Rating History for last three years:** Please refer Annexure-2
**Covenants of rated instrument / facility:** Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3
**Complexity level of various instruments rated for this company:** Annexure 4

**Annexure-1: Details of Instruments / Facilities**

| Name of the Instrument | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|
| Fund-based-Long Term | - | - | Mar-2025 | 45.00 | CARE BB+; Positive |
| Term Loan | - | - | | 8.32 | CARE BB+; Positive |
| Proposed | - | - | - | 0.68 | CARE BB+; Positive |

**Annexure-2: Rating History of last three years**

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating history | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2021-2022 | Date(s) & Rating(s) assigned in 2020-2021 | Date(s) & Rating(s) assigned in 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 |
| 1 | Fund-based-Long Term | LT | 54.00 | CARE BB+; Positive | | | | |

**Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: NA**

**Annexure 4: Complexity level of various instruments rated for this company**

| Sr. No | Name of instrument | Complexity level |
|---|---|---|
| 1 | Fund-based-Long Term | Simple |

**Annexure-5: Name of the companies consolidated with ZCCL**

| Sr. No. | Subsidiary | Shareholding |
|---|---|---|
| | | As on March 31, 2021 |
| 1 | Zodiac Clothing Co. S.A. | 100% |
| 2 | Zodiac Clothing Co. (UAE) LLC. | 100% |
| 3 | Zodiac Clothing Bangladesh limited | 100% |

***Note on complexity levels of the rated instrument:*** *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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