Zodiac Clothing Company Limited

September 06, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	54.19 (Reduced from 57.21)	CARE BB+; Negative	Reaffirmed; Outlook revised from Stable

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The rating continues to remain constrained by a continuance of operating losses on account of low top line as against increasing raw material cost and other operating expenses. However, the reaffirmation of the rating continues to factor in the improvement in revenue in FY23 at Rs.174.81 crores (FY22: 126.76 crores), low leverage and adequate liquidity.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Increase in its scale of operations with total operating income beyond Rs. 200 crores through volume driven growth on a sustained basis while maintaining PBILDT margin above 5% on a sustained basis.
- Improvement in its operating cycle to below 180 days on a sustained basis.

Negative factors

- Further pressure on revenues and earnings resulting in continuance of PBILDT margin being negative.
- 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 crores.

Analytical approach: Consolidated

The consolidation is on account of same management and operational linkages. The list of subsidiaries considered for consolidation is listed in Annexure- 6.

Outlook: Negative

The revision in ZCCL's outlook from Stable to Negative is on account of continuing PBILDT level losses as reflected by Q1FY24 numbers. Given the slowdown in demand against increasing fixed operating expense, the operating margin is expected to remain modest in near term.

Detailed description of the key rating drivers:

Key weaknesses

Continuance of operating losses:

ZCCL continues to book EBITDA loss at Rs.5.74 crores in Q1FY24 (FY23: EBITDA loss of Rs.7.50 crores; FY22: EBITDA loss of Rs. 16.51 crores). The company continues to book operating losses due to low top line, which remains insufficient to absorb the operating expenses, majorly raw material cost and low pricing flexibility. With addition of new stores and low top line backed by slowdown in demand observed in global market, CARE Edge expects the operating margin to remain modest in near term. The improvement in operating margin in medium term is subjective to increasing share of branded product via its Bangladesh unit or ZCCL's plan of increasing the PAN India presence.

Continuance of small scale of operations; albeit with an improvement: ZCCL's scale of operations continues to remain small as reflected by total income from operations at Rs.174.81 crores in FY23 (FY22: Rs. 126.76 crores). The revenue growth of

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

38% is driven by both sales volume as well as realisation. Though the company is geographically diversified, with high export exposure, the same is expected to be impacted in near term given slowdown in demand in the global market. The improvement in top line is subjective to execution of management's plan in adding more stores across PAN India, more initiatives in digital marketing and start up and stabilisation of operations at Bangladesh unit.

The trial production at Bangladesh unit was expected to start from September 2022 with commercial production from January 2023. However, same has got delayed with trial production to start from September 2023. The delay was due to delay in compliance and regulatory approvals.

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. Though the average working capital cycle has improved to 124 days in FY23 (FY22: 202 days), it continues to remain elongated. Reduction in both inventory days and receivable days has been seen in FY23 at 127days (FY22: 209 days) and 48 days (FY22: 58 days), respectively.

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.

Foreign currency fluctuation risk:
The company continues to remain net exporter as only 40% of raw material procured is imported against exports of 60%. Also, 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.

Key strengths

Diversified geographical presence: ZCCL has diversified geographical presence across India and across the globe. The company enjoys an established track record with its clients in the exports business. Out of the total revenue, export exposure continues to remain higher in total revenue. Export continues to contribute 60% towards revenue. The company has 104 stores and MBO's of 816. ZCCL continues to monitor the performance of the stores on half yearly basis, which enable them to close the non-performing stores and thus control the cost.

Continuance of comfortable capital structure: ZCCL's overall gearing continues to remain below unity with scheduled repayment of existing debt and no significant additional loans. 61% of total debt comprises of working capital limit, another 34% is that of lease liabilities and rest is ECLGS loan. With no major debt led capex plan of the company, the capital structure is expected to remain comfortable in near to mid-term.

Liquidity: Adequate

The liquidity of the company continues to remain adequate with its liquid investment worth Rs.52.31 crores in form of mutual funds, investments in stock of listed entities. Moreover, the maximum average utilisation of fund-based limits is comfortable at 71% for last twelve months ended July 31, 2023. Against these sources of liquidity, the repayment obligation is of Rs.12.38 crore and Rs. 12.20 crores for FY24 & FY25, respectively. The said repayment majorly includes lease payment while bank loan principal payment is Rs. 2.77 crores and Rs.2.59 crores in FY23 & FY24. The cash and cash equivalents as on March 31, 2023 stood at Rs.10.96 crores.

Applicable criteria

Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities

[Rating Outlook and Credit Watch](#)
[Short Term Instruments](#)
[Cotton Textile](#)
[Manufacturing Companies](#)

About the company and industry

Industry classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Consumer Discretionary	Textiles	Textiles & Apparels	Garments & Apparels

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 (FY22:62%). The domestic branded business is mainly routed through exclusive brand outlets (EBOs) and multi-brand outlets (MBOs). The stores of the company spread over in 40 cities 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 (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	Q1FY24 (UA)
Total operating income	126.76	174.81	32.98
PBILDT	-16.51	-7.50	-5.74
PAT	-16.37	5.98	-9.16
Overall gearing (times)	0.30	0.24	NA
Interest coverage (times)	-2.27	-1.10	-3.96

A: Audited UA: Unaudited; NA: Not available; Note: 'the above results are latest financial results available'

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: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based-Long Term		-	-	March 2025	54.19	CARE BB+; Negative

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based-Long Term	LT	54.19	CARE BB+; Negative	-	1)CARE BB+; Stable (26-Sep-22)	1)CARE BB+; Positive (11-Oct-21)	-

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities- Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based-Long Term	Simple

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Annexure-6: Name of the companies consolidated with ZCCL

Sr. No.	Subsidiary	Shareholding As on March 31, 2023
1	Zodiac Clothing Co. S.A	100%
2	Zodiac Clothing Co. (UAE) LLC.	100%
3	Zodiac Clothing Bangladesh Limited	100%
4	Zodiac Clothing Company INC	100%

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

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