Zodiac Clothing Company Limited

September 26, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	57.21 (Enhanced from 54.00)	CARE BB+; Stable (Double B Plus; Outlook: Stable)	Reaffirmed; Outlook revised from Positive
Total Bank Facilities	**57.21** **(₹ Fifty-Seven Crore and Twenty-One Lakhs Only)**		

Details of instruments/facilities in Annexure-1.

Detailed Rationale & Key Rating Drivers

The reaffirmation of the rating factors in, ZCCL's improvement in revenue in FY22 as well as Q1FY23 vis-à-vis previous year, diversified geographical presence, experienced promoters, adequate liquidity of the company in form of liquid investment and its low leverage. The rating continues to remain constrained by continuance of losses on account of intense competition and low-price flexibility.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Increase in its scale of operations with total operating income beyond Rs. 200 crores through volume driven growth on a sustained basis.
- Improvement in its PBILDT margin above 5% 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:

- 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.

Outlook: Stable

ZCCL's outlook has now been revised from Positive to Stable on account of continuing PBILDT level losses during FY 22 & Q1FY23 and due to significant variance in profitability envisaged earlier for FY22 vis-a-vis the actuals of FY22.

Detailed description of the key rating drivers

Key rating weaknesses

Continuance of operating losses: ZCCL continues to book EBITDA loss at Rs. 16.51 crores during FY 22 (FY21: loss of Rs. 21.73 crores). Though the losses have been narrowed down, the company continues at negative profitability on account of low pricing flexibility. Lower sales on account of competition in the market against the increasing operating cost has continued to impact the profitability of the company. The full impact of measures such as reduction in operating cost by switching the rental cost on revenue sharing model and lower personnel cost has resulted in restricting the PBILDT losses in FY22. In Q1FY23, ZCCL booked PBILDT losses at Rs. 2.14 crores (Q1FY22: loss of Rs. 6.56 crores; Q4FY22: loss of Rs. 3.85 crores). The operating loss was contracted in Q1FY23, considering higher sales achieved by the company as against the stabilised overall operational cost in the quarter. In addition to this, ZCCL's lack of backward integration continues to constrain the company in cost optimisation. Going forward, the profitability of the company continues to be the key monitorable.

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

Improvement in revenue albeit operations continue to operate at small scale: ZCCL 's scale of operations continues to remain small as reflected by total income from operations at Rs. 126.76 crores in FY22 (FY21: Rs. 100.45 crores). The revenue growth of 26% in FY22 is driven by pent-up demand and consumer demographics which further resulted in improvement in sales volume as well as prices. Given the gradual uptick in demand, the company was able to operate at 43.08% of its capacity in FY22 (FY21: 35.26%). The revenue is estimated to improve from FY23 considering the opening of economy leading to increase in demand and commencement of commercial production in Bangladesh unit. The said unit is expected to benefit the company in terms of both productivity and manageable employee cost.

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 202 days in FY22 (FY21: 274 days), it continues to remain elongated. Reduction in both inventory days and receivable days has been seen in FY22 at 209 days (FY21: 275 days) and 58 days (FY21: 66 days), respectively. As on March 31, 2022, ZCCL has receivable amounting to Rs. 26.13 crores (FY20: Rs. 20.23 crores) in form of export benefit and GST refund. As per the management, the clearing of receivables is going to aid the company in terms of liquidity and funding the marginal capex.

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: As on March 31, 2022; total foreign exchange earnings stood at Rs. 74.61 crore against Rs. 21.08 crore of foreign exchange outgo. Hence, ZCCL continues to remain a net exporter. As only 40% of raw material procurement is imported, the foreign exchange outgo remains low. 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. ZCCL in FY22 made forex gain of Rs 0.1 Cr (FY21: gain of Rs 0.27 crore)

Key rating strengths

Gradual contribution from completed capex: ZCCL has set up a manufacturing unit in Bangladesh with total cost of Rs. 7.00 crores incurred till date with expenses incurred only in purchase of machineries and electrical installation. The funding was done through cash balance. The commercial production is scheduled from January 2023. The set-up unit would be able to reduce the cost and transit time for its export customers and hence is of strategic importance to ZCCL in increasing the sales volume. The expansion in installed capacity is scheduled to happen in phases. The current capacity of Bangladesh unit is 2500 pieces per day which will gradually increase to 10,000 pieces by FY25-FY26. As per the management, as the expansion is scheduled to proceed in three phases, Rs. 3.00 crores would be the funding for each phase. The funding of the upcoming capex would be either in form of cashflow from refunds that continued to remain with the government in form of refunds or the promoters would infuse the money to the extent.

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 is higher in total revenue. Following two years of declining trend in both domestics and export market, the company was able to achieve 50% and 26% revenue growth in domestic and export segment. Export continues to contribute more than 60% towards revenue. As on date, the company has 104 stores (FY21: 132 stores; FY20: 164 stores). The MBO's as on September 2022 have been reduced to 816 (FY22: 968; FY21: 1009). ZCCL continues to monitor the performance of the stores on half yearly basis, which enable them to close the non-performing stores and hence there is variation in no. of stores annually.

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. 58% of total debt comprises of working capital limit, another

35% 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 investment in Mutual Fund worth Rs. 17.87 crores in Mutual Fund as on September 14,2022. In addition to this, ZCCL has investment of Rs. 10.59 crores in listed entities as on March 31, 2022. Moreover, the average maximum utilisation of fund-based limits (Rs. 50.00 crores) is comfortable at 73.20% for last twelve months ended August 31, 2022. ZCCL also has investment in private venture funds amounting to 37.84 crores as on March 31, 2022. This liquid investment continues to aid the liquidity profile of the company against the upcoming repayment of Rs. 10.64 crores and Rs. 17.80 crores for FY23 & FY24, respectively. The said repayment majorly includes lease payment while bank loan principal payment is Rs. 2.77 crores in FY23 & FY24. The cash and bank balance of the company stood at Rs. 9.27 crores as on March 31, 2022.

Analytical approach: Consolidated. The list of subsidiaries considered for consolidation is listed in Annexure- 6.

Applicable criteria

Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
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 (FY22). 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 (as on March 31, 2022) 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)	31-03-2021 (A)	31-03-2022 (A)	Q1FY23 (UA)
Total operating income	100.45	126.76	40.60
PBILDT	-21.74	-16.51	-2.14
PAT	-29.38	-16.37	-6.79
Overall gearing (times)	0.35	0.30	NA
Interest coverage (times)	-2.21	-2.27	-0.50

A: Audited; UA: Unaudited; NA: Not available

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: 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	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	57.21	CARE BB+; Stable

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 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based-Long Term	LT	57.21	CARE BB+; Stable	-	1)CARE BB+; Positive (11-Oct-21)	-	-

*Long term/Short term.

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

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: Bank lender details for this company

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

Annexure-5: Name of the companies consolidated with ZCCL

Sr. No.	Subsidiary	Shareholding As on March 31, 2022
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 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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About CARE Ratings Limited:

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With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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