

## Scotts Garments Limited

March 22, 2018

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long-term Bank Facilities-Term Loan	41.49 (reduced from 69.22)	CARE BB; Stable (Double B; Outlook: Stable)	Revised from CARE BBB; Stable (Triple B; Outlook: Stable)
Short-term Bank Facilities-Fund-based	429.73 (enhanced from 377.00)	CARE A4 (A Four)	Revised from CARE A3+ (A Three Plus)
Short-term Bank Facilities-Non-fund-based	40.30 (reduced from 65.30)	CARE A4 (A Four)	Revised from CARE A3+ (A Three Plus)
Total facilities	<b>511.52</b> <b>(Rupees Five Hundred Eleven crore and Fifty Two lakh only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The revision in ratings of bank facilities of Scotts Garments Limited (SGL) was on account of significant deterioration in the financial risk profile marked by significant decline in sales in 11MFY18 and stretched liquidity profile of the company marked by near full working capital utilization and increased inventory holding period. Further, the ratings of the company are constrained by customer and business concentration risk and exposure to foreign currency fluctuation. However, SGL continues to derive strength from the experienced promoter and management team, the company's long and good operational track record in the garments exports business with broad range of product profile, established and long-standing relation with reputed clients spread across global markets.

Going ahead, the ability of SGL to manage its working capital efficiently while maintaining healthy profitability margins, and enhance its addressable market by adding new customers to its existing clientele base while successfully managing its forex risk, would remain the key rating sensitivities.

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

#### **Significant deterioration in financial risk profile in FY18 with stretched liquidity**

Company's sales declined from Rs. 753.7 crore in FY16 to Rs. 666.9 crore in FY17 due to lower export orders during the year. Consequently, company's PBDIT margin declined from 13.82% in FY16 to 11.22% in FY17. However, due to lower interest expenses, company's net profit increased from Rs. 7.8 crore in FY16 to Rs. 10.1 crore in FY17.

However, the company's working capital cycle stretched further from 255 days in FY16 to 328 days in FY17 due to increase in inventory holding. The company's inventory levels are high as compared with its peers. Inventory holding period deteriorated from 198 days in FY15 to 221 days in FY16 and further to 256 days in FY17. This along with increase in receivables period, levy of 5% GST (as against nil tax earlier) on purchase of fabric and reduction in duty drawback to 2% (from 7.5%) led to increased WC requirements for the company. Company applied for increased WC with banks which is yet to be approved. Company's WC utilization remained near full for 12 months ending Dec 17. Due to stressed liquidity position, company couldn't take orders from its customers. During 11MFY18, company's sales was around Rs. 372 crore as against inventory holding of Rs. 414 crore as on Mar'17.

The company has also not commenced its recently completed Kolar plant due to inadequate WC facility.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and other CARE publications

**Customer and business concentration risk**

With around 20% of sales being derived from a single client *Best Seller*, SGL faces customer concentration risk. The top five clients accounted for 51.40% of the company's income in FY17 (52% in FY16), which makes its earnings highly vulnerable to the risks of the clients' financial health deteriorating. Furthermore, a significant share of the revenue is derived from Europe. The ability of the company to spread its markets and diversify its client base would be critical from a credit perspective.

**Exposure to foreign currency fluctuation**

While SGL is a net exporter, the timing and value differences between the receivables and payables in foreign currency (in the form of packing credit) lead to forex risk. This exposes SGL to forex rate risks and the company has reported forex fluctuation gain in FY17 of Rs. 0.78 crore (SGL reported losses in FY16 of Rs.16.26 crore). The company generally hedges 60-70% of the outstanding liability on its packing credit facility with forward contracts, and remaining exposure is kept open.

**Key Rating Strengths****Experienced management**

SGL is promoted by Mr Naseer Ahmed, Chairman and Managing Director, of the company. He was the former Minister of state for small scale industries in State of Karnataka, India during October 1990 to November 1992. The day-to-day operations of the company are looked after by Mr Naseer, who is adequately supported by a group of professionals.

**Established export base and long standing relationship with clients**

SGL primarily focuses on the export of manufactured Ready Made Garments and derives more than 74.98% of revenue from export market with European region contributing to about 70% of total export sales in FY17. SGL enjoys long standing relationship with several reputed clients across several global markets attributable to its long standing presence in the industry. However, the company's established export market and client base, its ability to get repeat business for greater volumes over the years, together mitigate the risk of customer concentration to an extent. SGL, has also taken steps towards expanding its client base and has continuously added new clients.

**Analytical approach:** Standalone performance of the company is assessed along with Corporate Guarantee extended to its group company, Inmark Retail Private Limited

**Applicable Criteria**

[CARE's Criteria on assigning Outlook to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[CARE's methodology for manufacturing companies](#)

[Financial ratios: Non-Financial sector](#)

[Short term instruments](#)

**About the Company**

Scotts Garments Limited is engaged in manufacture and exports of readymade garments. Company produces knitted, woven and denim garments for both genders across all ages. The company had an installed capacity of 315.18 lakh pieces per annum spread across units in Karnataka and Tamilnadu. SGL enjoys long standing relationship with several reputed clients across several global markets attributable to its long standing presence in the industry.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	753.73	666.97
PBILDT	104.20	74.85
PAT	7.79	10.06
Overall gearing (times)	1.66	1.67
Interest coverage (times)	1.85	1.86

**Status of non-cooperation with previous CRA:** ICRA has suspended the rating assigned to SGL vide its press release dated June 25, 2012 in the absence of requisite information

**Any other information:** Not Applicable.

**Rating History for last three years:** Please refer Annexure-2

**Note on complexity levels of the rated instrument:** CARE has classified instruments rated by it on the basis of complexity. This classification is available at [www.careratings.com](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

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**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 - LT-Term Loan	-	-	September 2020	41.49	CARE BB; Stable
Fund-based - ST-Working Capital Limits	-	-	-	429.73	CARE A4
Non-fund-based - ST-BG/LC	-	-	-	40.30	CARE A4

**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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based - LT-Term Loan	LT	41.49	CARE BB; Stable	-	1)CARE BBB; Stable (08-Feb-17) 2)CARE BBB; Stable (13-Jan-17)	1)CARE BBB (04-Feb-16)	1)CARE BBB (28-Jan-15)
2.	Fund-based - ST-Working Capital Limits	ST	429.73	CARE A4	-	1)CARE A3+ (08-Feb-17) 2)CARE A3+ (13-Jan-17)	1)CARE A3+ (04-Feb-16)	1)CARE A3+ (28-Jan-15)
3.	Non-fund-based - ST-BG/LC	ST	40.30	CARE A4	-	1)CARE A3+ (08-Feb-17) 2)CARE A3+ (13-Jan-17)	1)CARE A3+ (04-Feb-16)	1)CARE A3+ (28-Jan-15)

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