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Onicra's Outlook on SMEs In Readymade Garment Industry

FY: 2013-14

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OVERVIEW

This report by the Onicra rating team has tried to scan the micro and macro economic factors of garments industry and its impact on the players operating. Garments industry is one of the most dynamic sectors of the world and is the best example of consumer driven market. The global business has been fragmented into two categories 'the producers' and 'the consumers'. In recent years USA has emerged as the largest consumer on the other side Asia has shown its dominance in global production and export.

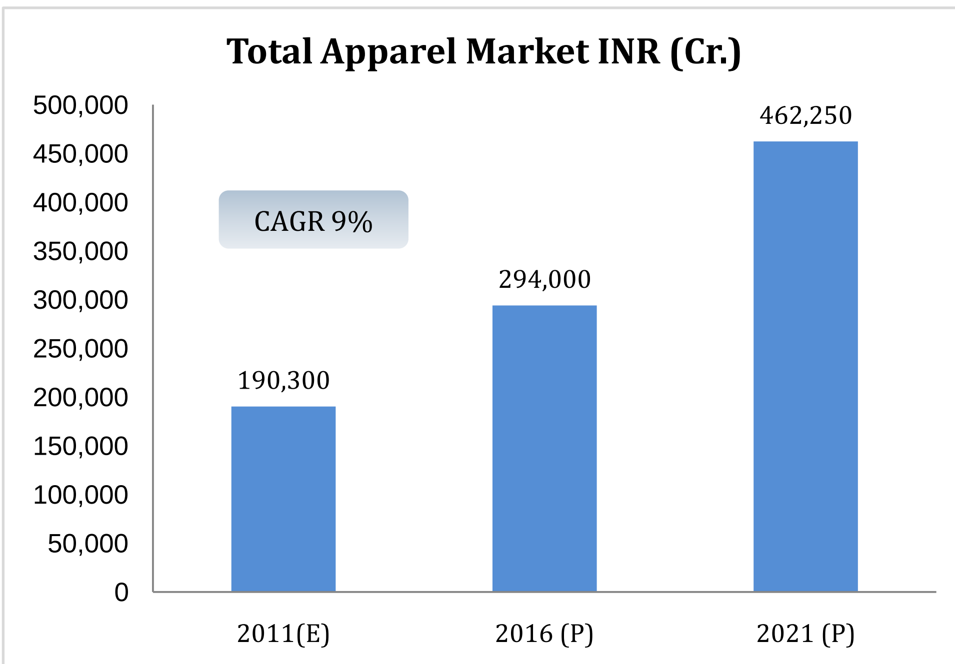
The countries contributing to Asia's production are China, India, Bangladesh and few others. The Asian countries are facing competition among themselves with China dominating the asian production & exports due to its advance technology, abundance of workforce and developed infrastructure.

India is the second largest producer of textile and garments with 24% of world spindle capacity. The indian apparel sector is one of the largest contributing sectors of India's exports worldwide, this sector contributes to 4% of India's GDP. The indian apparel exports have shown a robust growth in the past decade due to removal of quota export by the Government of India (GoI). The indian government has taken several initiatives to promote the textile and apparel industry with special attention for SME sector which contributes to more than half of the apparel industry. It has been noticed that the major segment of consumers are between the age group of 16-35 Years and there is a shift in demand from natural to man made fibres. The trends shows that the kids wear segment is growing at a faster pace than the other segments of the industry and the same is going to continue in the future.

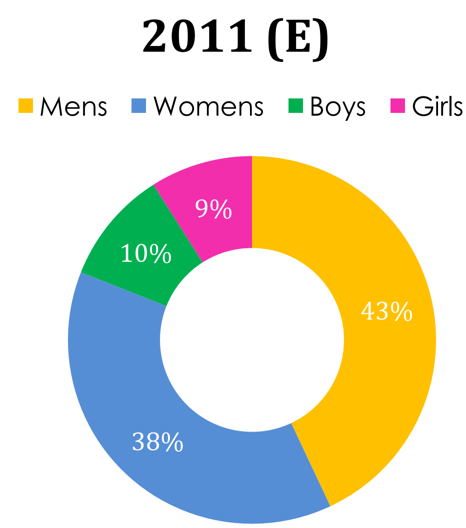
Marking the growth and demand of the industry the players have prepared themselves for the upcoming demands by doing technical enhancement, increasing their capacities and adopting stringent quality control measures. Government initiatives have played a pivotal role in the growth and development of the sector however, a lot has to be done in context of infrastructure, developed logistics, easy availability of funds for SMEs, R&D, innovation and skill development.

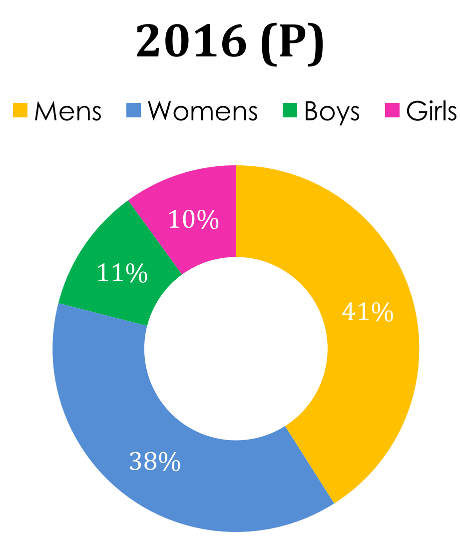
The Growth Story: Kids wear the fastest growing segment

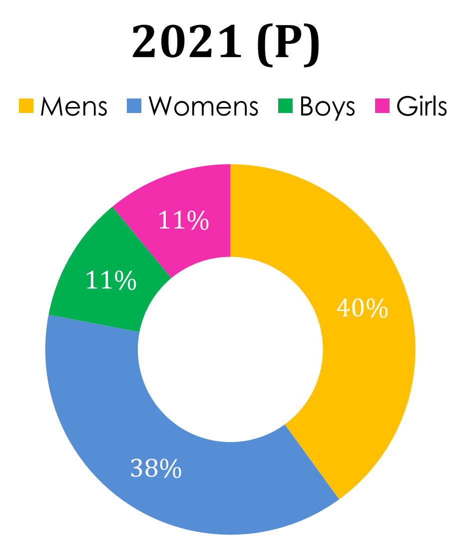
India's growing population has been a key driver for growth in readymade garment in the country complemented by the growing population which is exposed to changing taste and fashion and the rising female workforce participation. The domestic apparel industry which constitutes of four segments – mens wear, womens wear and kids wear (both girls and boys) is expected to record a compound annual growth rate (CAGR) of 9% over 2011-21. Currently, men's wear is the biggest segment of the apparel market constituting 43% of the total market; however, kids wear and women's wear are growing faster than men's segment (CAGR of 8%) and is expected to grow 10.5% and 9% respectively. As per Ministry of Textiles (MoT) the kids wear segment is anticipated to capture larger market share by the end of 2021.



Segment Split



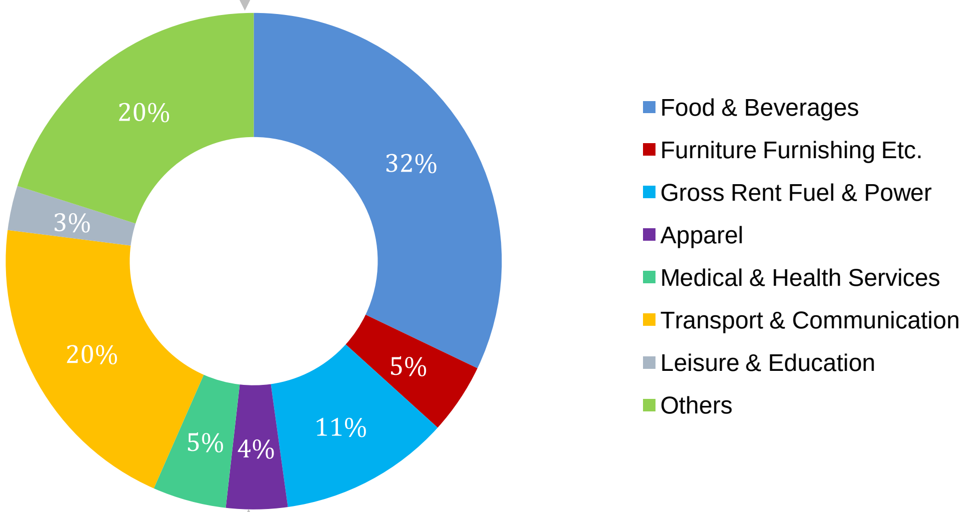




Source: Ministry of Textiles

India is the world's second largest producer of textiles and garments. Indian textile industry accounts for about 24% of the world's spindle capacity and 8% of global rotor capacity. Its predominant presence in the Indian economy is manifested in terms of its significant contribution to the industrial production (~14%), direct employment generation (35 million workforce) and foreign exchange earnings (~27%) in FY13. Today the Apperal industry contributes to almost 4% of the India's GDP.

The contribution of Apparel sector to GDP is 4%



GDP: USD 1.73 Trillion

Private Consumption
USD 1000 Billion (58%)

Public Spending & Investment
USD 730 Billion (42%)

Retail:
USD 470 Billion (47%)

Non Retail:
USD 530 Billion (53%)

Textile & Apparel
Domestic Market:
USD 58 Billion

Textile & Apparel
Exports:
USD 31 Billion (12%)

Apparel
USD 40 Billion (69%)

Apparel
USD 18 Billion (31%)

Apparel
USD 18 Billion (31%)

Apparel
USD 18 Billion (31%)

Source: Ministry of Textiles

The recent change in the government policies to remove excise duty, allowing 100% foreign direct investment (FDI), de- reservation of readymade garments, hosiery and knitwear from the SSI sector, extension of 2% Rupee Export Credit Interest Rate Subvention Scheme for readymade garments till 31st March 2014 and interest rate subvention of 2% extended on pre and post shipment rupee export credit for readymade garments has provided a supportive platform for higher growth. Also withdrawal of nearly 16% countervailing duty (CVD) on import of readymade garments products from Bangladesh would raise exports to nearly 35.00% in the first seven months of the current fiscal year It is estimated that textile industry will require `13,200 Crore of new capital investments over the next five years.

Other initiatives by Government of India (GoI)

- Ministry of Textile were allotted ` 50 crore to initiate setting up apparel parks within the Scheme for Integrated Textile Parks (SITP) to house apparel manufacturing units. Till date, 61 textile parks are sanctioned under the scheme and are expected to generate over 1 million jobs.
- Under the Apparel Parks For Export Scheme, 12 projects are sanctioned with the Government of India's share of ` 190 crore.
- The Clothing Manufacturers Association of India (CMAI) signed a MOU with Mauritius Export Association (MEXA) to strengthen the cooperation in the field of fashion and design promotion, education and training through effective knowledge network of textiles professional and industry representatives of India and Mauritius
- The Ministry of Textiles commenced an initiative to establish institutes under the public-private partnership (PPP) model to encourage private sector participation in the development of the industry.

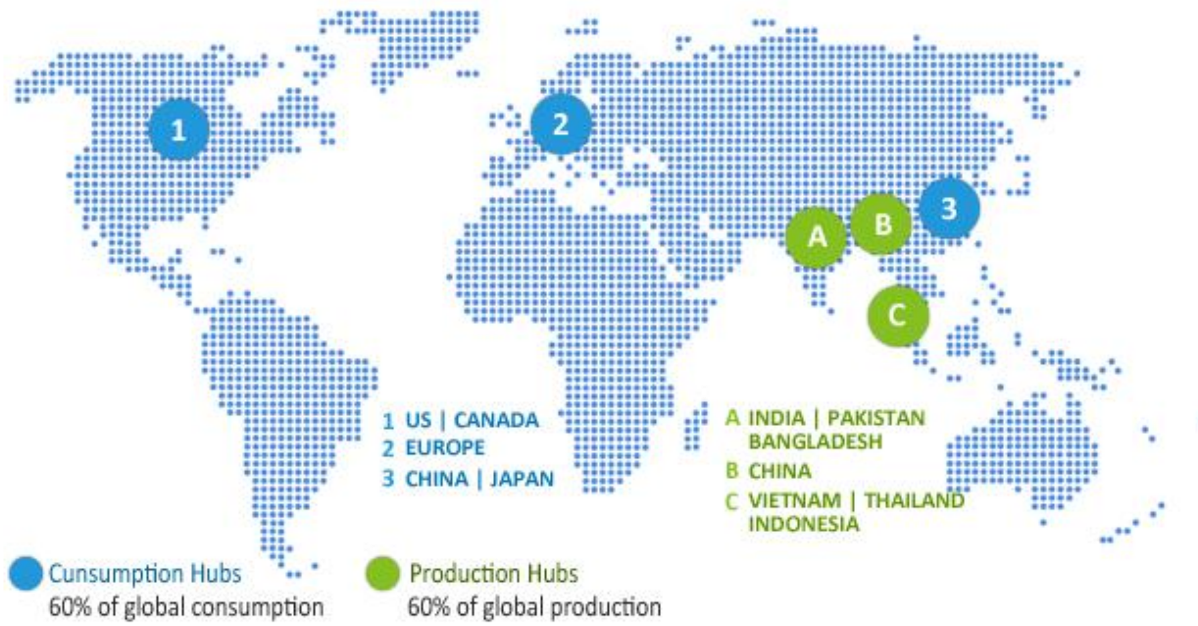
Apart from the measures which are taken by the government there are various body which are also working towards the growth of readymade garments sectors such as Apparel Export Promotion Council (AEPC) which is a official body of apparel exporters in India that provides invaluable assistance to Indian exporters as well as importers who choose India as their preferred sourcing destination for garments.

Outlook on demand: Strong Domestic and Global Demand Expected

India's garment industry is one of the mainstays of the national economy. It contribute 69% to textile market share in the FY12 and it is also one of the largest contributing sectors of India's exports worldwide. Exports of readymade garments depicted a robust 24.80% growth in FY12 to reach `62,630 crore against 5.40% growth in FY11. Exports of garment products from India have increased steadily over the last few years, particularly after 2004 when textiles exports quota was discontinued. The industry is now exploring markets of Japan, Middle East and South America which have a huge potential for readymade garment exports.

The largest segment for the readymade garment segment includes the age-group of 16-35 years old people that is very brand conscious and gives priority to high quality. The sector has been growing as the disposable income of the people are rising, the preference of the consumer are changing from 'need based' to 'experience based'. Branded readymade garments accounts for over 21% of the readymade garment industry. Man Made fabric (MMF) is in great demand and has recorded an increase of about 2% in FY13 and production stood at 1,23,000 crore tones in FY12. India's domestic ready made garments market is estimated at around `2 lac crore, with the unorganized sector accounting for more than half of the market.

Textile and garments sector occupies significant position in total volume of merchandise trade across countries. The textile and apparel trade was estimated to be Rs. 42.50 lac crore in 2011 and is expected to grow at a CAGR of 5% in the next 10 years. In the global textile market the consumption hub is USA, Canada, European Union, China and Japan contributing to more than 60% of the global consumption.



Source: Ministry of Textiles

To cater the demand more and more production is required which depends upon the availability of raw material and manpower. The readymade garment manufacturing is highly labour intensive and is therefore characterized by low entry barriers. It is second in terms of employment generation after agriculture industry. The availability of cheap labor is one of the factor for the movement of MNCs from developed nation to developing nation.

Dominance of Asian players in global trade

USA in the year 2005 removed the quota system on textile and garments imports which resulted into heavy import of the goods. Asia being the principal exporter benifited by the move. Countries like India, China, Bangladesh, Pakistan, Vietnam, Thailand and Indonesia are considered as the production hubs contributes to more than 60% of global producion. India is one of the leading suppliers of readymade garments both in USA and EU. This shows that the developed nations are highly dependent on the developing countries for

one of the basic requirement of living "Garments". The reason for such dependence is cheap manpower and availability of raw materials in the developing nations. This edge of developing countries over developed countries is attracting the MNCs to invest in these countries. India is one of the major contributors in garments manufacturing and export as well.

However, in order to safeguard the interest of domestic manufacturers US government imposed certain restrictions on import of garments. This move had a negative impact on manufacturers who had their facility in other countries. Many countries still have the quota system to safeguard the interest of their domestic manufacturers. Other move to safeguard the interest of domestic producer is increasing import duty to bring the cost of domestic & imported goods at par.

Position of India unstable in the global markets

India is one of the favorite spot in the eyes of international investors for garments manufacturing and export. In the global market exports of clothing, India ranked as the fifth largest exporter as per WTO data – 2011, trailing Bangladesh, Hong Kong, EU-27 and China. In the global exports of textiles, India ranked as the third largest exporter, trailing EU-27 and China, as per WTO data – 2011. Key factors affecting the industry over the past five years were population growth, disposable income levels and international trade levels. Consumers need clothing for practical reasons, causing demand to grow as the global population increases. Industry revenue is forecasted to grow strongly over the five years through 2017, as demand from growing middle classes in emerging economies becomes even stronger. Concentration in the industry has increased slightly over the past five years due to mergers and acquisition of industry participants.

However India's position in global arena is on a shaky platform as it is facing tough competition from its neighboring countries such as China & Bangladesh. Talking about these three Asian countries the labor in Bangladesh is cheapest and India's labor is costliest. China is technologically more advance than India and Bangladesh and in terms of fabric especially silk, Bangladesh is the leader. The fuel prices in India are the highest among these countries. China is the leader in exports with more than 40% market share. From the above point it can clearly be inferred that India is not in a leading position and will have to toil to reap success.

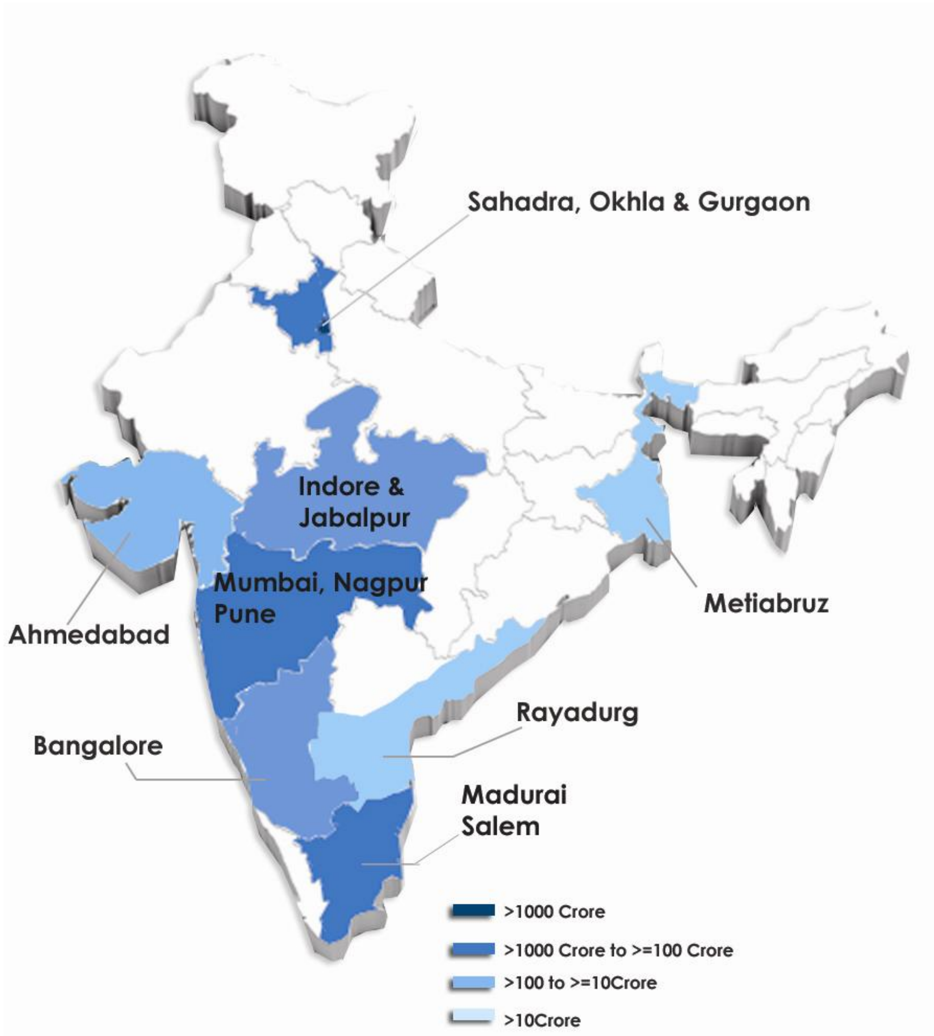
Adding to the trouble is the Indian government's unilateral trade initiative of opening its door for duty free trade of 46 textile items from Bangladesh. This move is lethal for domestic garments manufacturer and the most affected clusters would be Tirupur, Ludhiana and West Bengal however this move will help Bangladesh to increase its revenue by more than double.

To overcome these challenges government have taken many initiatives one of which is 100% FDI by automatic route. This will attract the foreign investor to invest in the indian market, increasing the chance of India to increse its overall marketshare.

Onicra's Outlook on SME's in readymade garment industry

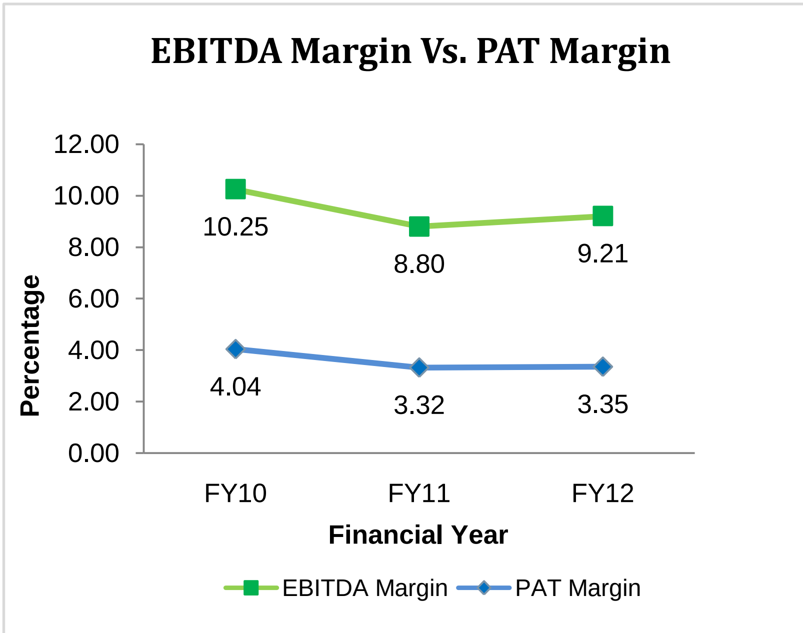
According to United Nations Industrial Development Organization (UNIDO) there are 13 SME clusters of ready made garments in India. Among the 13 clusters Tamil Nadu, Maharashtra and NCR region is leading the chart in terms of annual turnover. In terms of exports Madhya Pradesh, Maharashtra, Andra Pradesh, Gujarat and Delhi are leading from the front, however after generating the maximum employment and maximun number of units West Bengal still lags in terms of turnover.

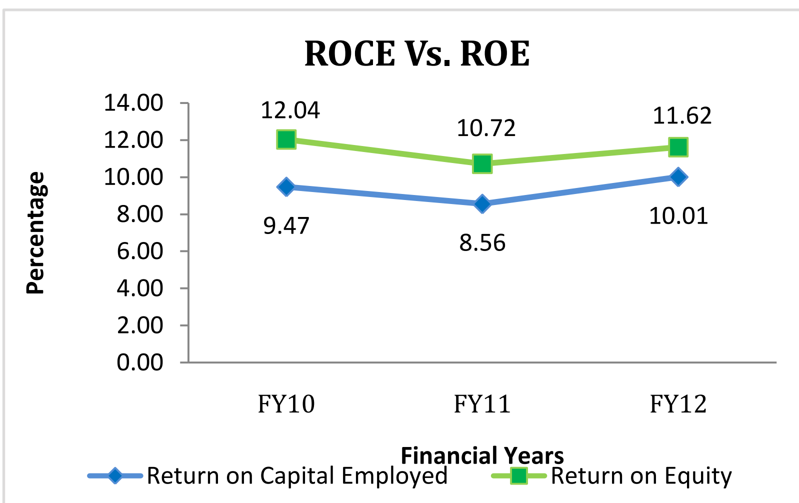
13 SMEs clusters for ready made garments in India



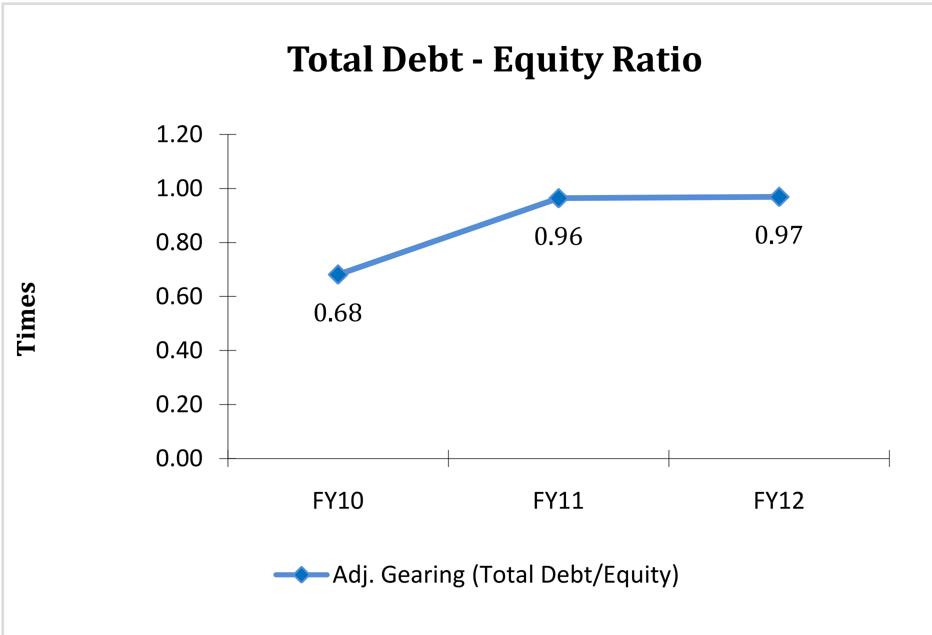
Source: Ministry of textile

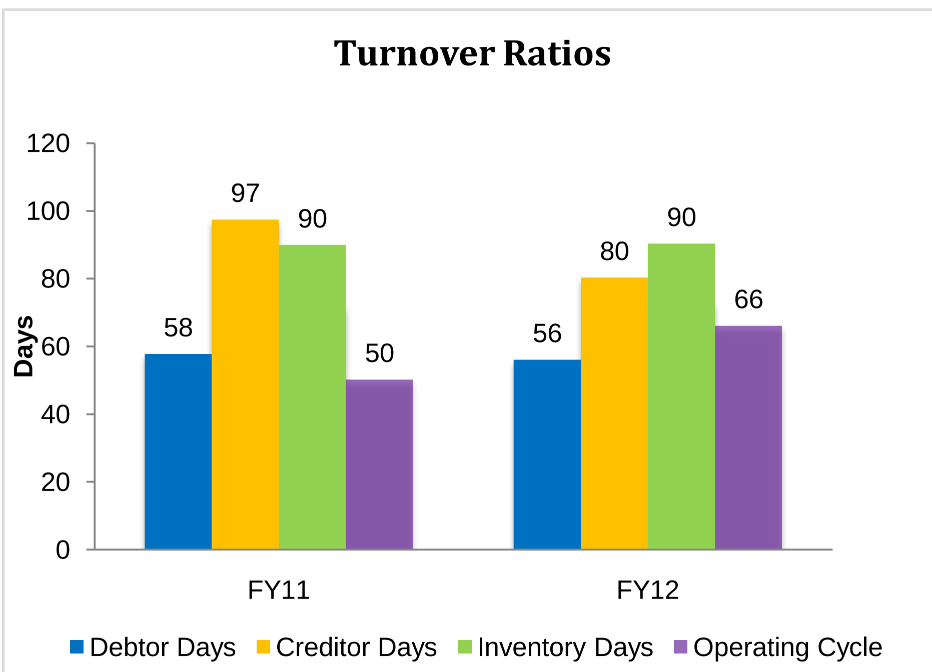
Financial Outlook [1]

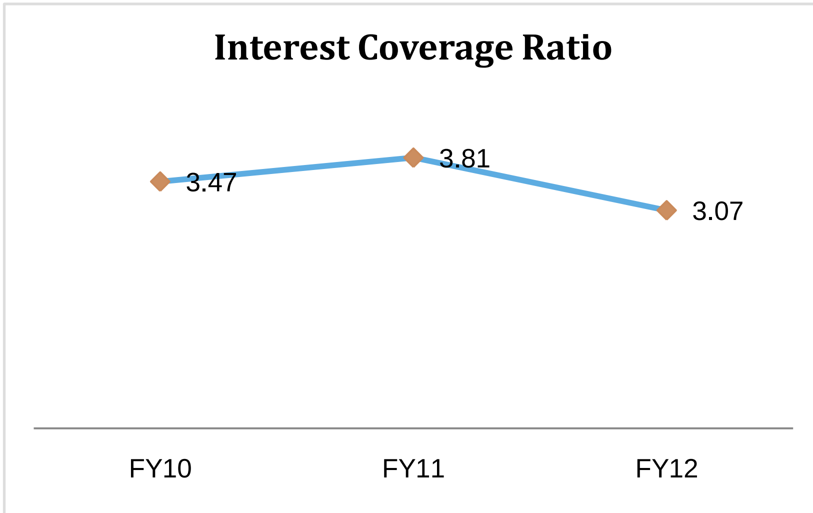




[1] A sample data of 30 companies across India was chosen from the entities that have been rated by Onicra during the period January'2013 to June'2013 as a representative of the SME units. These entities are involved in manufacturing of readymade garments and have a turnover slab of more than `2 crore.


Total Debt - Equity Ratio
Times
1.20
1.00
0.80
0.60
0.40
0.20
0.00
0.68
0.96
0.97
FY10
FY11
FY12
Adj. Gearing (Total Debt/Equity)


Turnover Ratios
Days
120
100
80
60
40
20
0
58
97
90
50
56
80
90
66
FY11
FY12
Debtor Days
Creditor Days
Inventory Days
Operating Cycle



Revenue growth remained strong driven by increased demand in both import and export market, however, margins (EBITDA) remained constrained: out of the total sample, 73% of the units have posted an increase in revenue during all the financial years under study which depicts incraese in demand of readymade garments. However, margins remained stagnant as most of the companies were unable to control over its fixed overheads. The EBITDA margin has declined to 9.21% for FY12 as against 10.25% for FY10. Onicra believes that the overall profitability of industry will remain constrained in near short term on account of devaluating rupee, increase in raw material prices, soaring fuel prices and higher labour costs.

Similarly, PAT margin remained subdude on account of account of high interest payments made for short and long term borrowings of the units which is also depicted by a higher average cost of borrowings and a moderate interest service coverage ratio. Onicra expects that the overall profitability of the SMEs involved in readymade garment manufacturing to remain constrained on account of increased interest payments.

The returns generated by the rated sample remained stable for all the financial years under study with a marginal increment in FY12. As decribed earlier a lot is needed to be done by the units to limit their overhead expenses in order to generate higher returns.

The business units rated by Onicra has exposure to debt which is almost equivalent to equity invested in the business. The major portion of debt (66% of total borrowing outstanding as on 31 March 2012) comprised of working capital loans primarily taken to fund inventory. More concentrated efforts is needed from the government's side on easy financing to readymade garments SMEs, so that they can expand further.

Challenges that Onicra foresee

Although Government of India's several cluster development initiatives involving technical assistance, subsidies for technology upgradation and marketing support has strengthened the competitiveness of the SMEs and provided them with economy of scale, bargaining power, networking oppertunities and competiveness they are also challanged by various limitations. Some of them are stated below:

- Due to intense competition among various players, 65% of the merchandise is sold at a discounted rate as against 40% earlier.
- Intense competition from the leading brand and their attractive discounting policy has made SMEs difficult to operate.
- SMEs can concentrate only in few cities and towns and as the disposable income of the people is increasing it is difficult for them to operate.
- Due to limited capacity restriction these SMEs cannot operate beyond a certain level. Additionally, inadequate logistics and improper supply chain managements has created huge problems for the smaller players.

- For advertising and brand building, these smaller players are forced to extend their reach geographically, which makes their supply chain management more complex. To match with increasing demand in competitive markets, stress on producing volumes also has increased. To sustain existence these players will have to inject in more investments to their businesses in the areas of designing capabilities, brand making and retailing.

- It is difficult for the SMEs to raise funds from outside as they are highly hit by any non-conductive/conducive change in its macro environment.
- Lack of skilled labour in the sector
- Rising cotton and yarn prices which are very much dependent on macro environment.

The Indian economy being exposed to global economic environment has been impacted by the global uncertainties. In addition, on the internal front, the economy is facing challenges due to inflationary pressures, tight monetary conditions and low investments, delays in policy decision, high interest rates, slowing GDP growth, currency depreciation, fuel shortages, weak off-takers, execution delays and prospects of slowing traffic growth for transportation.

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