ANUSH SHARES & SECURITIES

Initial Public Offer Review

Scotts Garments Limited

Retail Equity Research

24th April 2013

Recommendation: AVOID

ANUSH RESEARCH: IPO Recommendation: Do not Subscribe

NEW PUBLIC ISSUE INFORMATION

- IPO opens: 25-29 Apr 2013
- Issue Type: 100% Book Built Issue IPO
- Price band: Rs. 130 to Rs. 132 per share
- Face value: Rs. 10
- Issue Size: 10,506,954 Equity Shares of Rs. 10
- Minimum bid: 100 shares
- Minimum investment: 100 shares
- Lead managers: Keynote corp. services Ltd and Canara Bank
- Registrar: Link Intime India Private Ltd
- Listing: BSE / NSE
- CARE Rank: Grade 3 to this IPO indicating at average fundamentals of the company.

OBJECTIVE OF THE ISSUE

- Setting up of unit for Trouser manufacturing and Knitting and Fabric Processing at Kagal in Karnataka.
- Margin Money for working capital of the new unit.
- General corporate purpose and meet the issue expenses.

COMPANY BACKGROUND:

Scotts Garments Limited was established in 1992 and it is a Bangalore based Garment manufacturing company. In addition to manufacture of superior quality garments, company also provides additional services such as embroidery, printing, dyeing and washing. Scott export their readymade knitted and woven apparel to international clients including DENMARK, GANDER MOUNTAIN – USA, S OLIVER, FRANKFURT, C&A BUYING AND GERMANY.

Scotts Garments specializes in tailor made products for men, women & kids. Products manufactured by the company includes Shirts (Cotton & Denim) Tops, Skirts, Trouser (Cotton & Denim), Shorts, Cargos, Knitted Garments, T-Shirts (Basic and Embroidered), Sweats and Jerseys. They export their quality products to several MNC's into more than 20 countries across the Globe. They have set up an exclusive display showroom at Apparel Export Promotion Council in Gurgaon.

Scotts has also set up a 2.1 M.W capacity windmill at Bellary in Karnataka. Scotts Garments has also entered into Wheeling and Banking agreement with Gulbarga Electricity Supply Company Limited for the sale of the power generated through the wind mill. The company has also signed a Wheeling and Banking agreement with Tamil Nadu electricity board for the sale of power through wind mill at Tirunelveli District in Tamil Nadu.

WHY ARE WE NOT COMFORTABLE WITH THE COMPANY?

- **Europe dependence:** Over 90% of revenues come from exports and substantial share of exports is concentrated in European region (76% of exports). The economic turmoil in Europe does not indicate substantial growth opportunity in future for Scotts Garments.

- **Low margin business**: The garment manufacturing and processing industry has substantial competition and has the characteristics of sub-contractor business model with wafer thin margins.

- **B2B business model**: High concentration of customer base. Top 10 customers account for 81% of total sales. The company has limited direct to consumer business.

- **Almost nil pricing power**: The profitability of the industry hinges on commodity cost cycle of cotton, polyester and denim fabrics in Indian market and ability to pass on in terms of pricing to its customers.

SOME KEY CONSIDERATIONS

- In BRLM's performance front, Keynote Corporate had mandate for 17 IPOs out of which 8 failed to give listing day gains. For Canara Bank this is perhaps first mandate after very long time.

- If we characterize the annualized earnings on the post IPO equity base of Rs. 38.98 Crores then the issue price is at a P/E of 14.5x. Its peers are trading between 10x to 16x which indicate that the issue price does not provide valuation comfort considering the nature of industry and risk factors.

- Even though garment industry is balanced for bright prospects ahead as per recent budget, bearing in mind listing in "T "group for initial period, it is better to avoid the stock.

FINANCIAL REVIEW

- Sales grew at a CAGR of 11% FY 2009-12 indicating a single digit volume growth supported by INR currency depreciation.
- Sustainable PAT margins at 7% although FY12 margins stand at 16.8%. Scotts Garments has been operating around 7% PAT margins up to FY 2010-11. For FY2011-12, the margins showed a vertical jump to 14.85% due to increase in extra income. For Seven months ended Oct 12, the margins are at 6.09%. The margins are stabilized around 6% -7% in the last five years.
- Highly leveraged company with pre-issue debt equity ratio at 1.25. The business model depends on high leverage to grow and hence it is quite difficult to expect the company to deleverage through operating cash flow.

RECOMMENDATION: DO NOT SUBSCRIBE

- IPO pricing at non-attractive levels to consider a subscription to the issue. In our view, Investors are unlikely to gain in the near term. We recommend the investors to miss the IPO and **avoid** considering any investment even post IPO until fundamental improve.

For any assistance contact us at analyst@anushshares.com or + 91 44 24616234

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