

# K E Y N O T E

## I P O N O T E

### Sudar Garments Ltd.

February 19, 2011

|                                   |  |
|-----------------------------------|--|
| <b>Price Band</b>                 | : ₹72-77 per share                             |
| <b>Minimum Bid Lot Size</b>       | : 81 Equity Shares                             |
| <b>Maximum Bid Lot Size</b>       | : 2,592 Equity Shares                          |
| <b>IPO open during</b>            | : February 21 - 24, 2011                       |
| <b>Book Running Lead Managers</b> | : Ashika Capital Ltd.                          |
| <b>To list on</b>                 | : NSE & BSE                                    |
| <b>IPO Grading</b>                | : 1 / 5 (CRISIL)                               |
| <b>PE</b>                         | : 7.92x (based on base price)*                 |
|                                   | : 8.47x (based on cap price)*                  |
| <b>Market Cap post-listing</b>    | : ₹142.81Cr or \$32mn (based on the cap price) |
| <b>Market Cap of Free Float</b>   | : ₹77.19Cr or \$17mn (based on the cap price)  |

\* based on EPS of FY10

IPO of mn equity shares of ₹10 each, aggregating to ₹70Cr or \$15.5mn (at the cap price)

### Shareholding Pattern

| Shareholder Categories      | Pre-Issue      |            | Post-Issue      |            |
|-----------------------------|----------------|------------|-----------------|------------|
|                             | No. of Shares  | % Holding  | No. of Shares   | % Holding  |
| Promoters & Promoters Group | 8521375        | 90.09      | 8521375         | 45.94      |
| QIBs excl. Mutual Funds     | 0              | 0          | 10025600        | 54.06      |
| Mutual Funds                | 0              | 0          |                 |            |
| Non-Institutional Investors | 0              | 0          |                 |            |
| Public                      | 937600         | 9.91       |                 |            |
| <b>Total</b>                | <b>9458975</b> | <b>100</b> | <b>18546975</b> | <b>100</b> |

Note: Dilution Of 49% (fully post issue paid up capital)

### Executive Summary

- Sudar Garments Ltd. (SGL) engaged in the manufacturing of garments for Men wear, Women wear and Kids wear. SGL operates as an integrated apparel manufacturer with the capability of designing and manufacturing involving cutting, body stitching, washing, ironing and finishing.
- The manufacturing facility of SGL is setup at Raigad, Maharashtra with a built-up area of about, 29,626 Sq. Mtrs. having a combined capacity of producing 1,66,667 pieces of shirts, dress, pants tops, skirts, and denims per month.
- The management of SGL has wide experience in the field of apparel manufacturing, which helps the company to understand the consumer preference in a better way.
- SGL's core competency lies in its in-house manufacturing and embroidery skills. Right from sourcing the raw material to manufacturing which includes, dyeing, and washing of the readymade garments is carried out in-house including packaging and dispatching of finished goods.
- SGL follows ERP process, an advance logistic system, which enables it to control inventory. This also helps the company in effectively servicing the requirements of its distributor and multi brand outlet.
- SGL use latest technology and machinery procured from major suppliers/distributors in India. These modern machineries help SGL in maintaining high quality standards, enables radical design and innovation in creating new look and new trends.

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**Our View**

IPO priced at 17.5x to annualized earnings for FY11 based on the diluted equity at a higher price band seems to be expensive. Besides that the issue raised by the IPO Grading Agency, CRISIL and its fundamental grade of 1/5 shows the weakness in the issue. Looking into unsustainable financial growth in future, it is suggested for investors to take a cautious view and may avoid subscription.

**Company Background**

Sudar Garments Ltd. (SGL) was incorporated in January 2002 as Sudar Garments Private Ltd. The name of the Company was changed to Sudar Garments Ltd. on conversion into public limited company. SGL operates as an integrated apparel manufacturer with the capability of designing and manufacturing involving cutting, body stitching, washing, ironing and finishing. It specializes in shirts, trousers and wide range of other apparel.

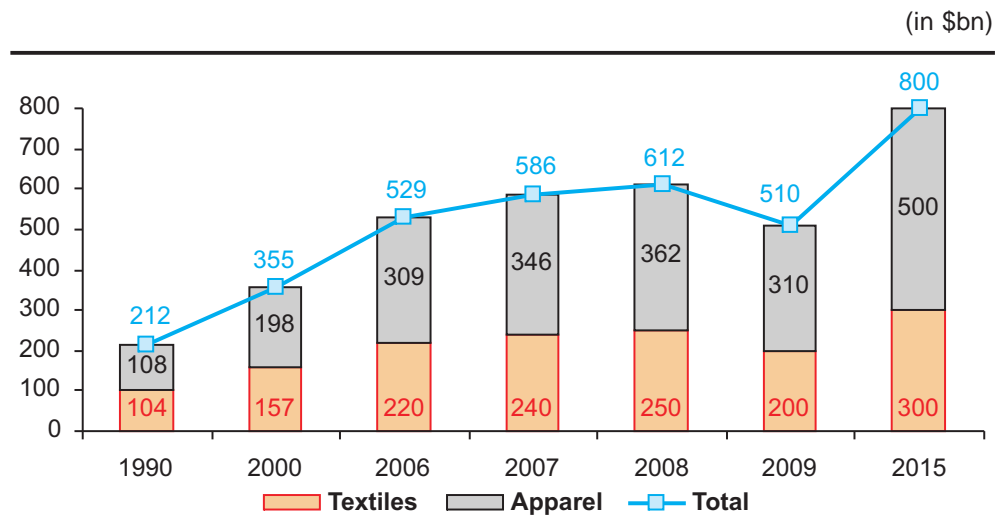
**Promoters and Management**

**Mr. Murugan Muthiah Thevar** is the founder and Promoter and currently the Chairman and Managing Director of SGL. He has been associated with the apparel manufacturing business since 1992. He is responsible for developing business strategies and instrumental in formulating strategic growth of the company. He also undertakes conceiving new and modern innovations in processing fabrics for use in the manufacture of garments.

**Mr. Gopi Chellapan Nair** is a Whole Time Director of SGL having over two decades of experience in the apparels industry. He is responsible for manufacturing and marketing & also overlooking designing, styling, building up collection of apparels for each season. He has also worked in various garments exports company namely Ambreen Exports, Associated Indian Exports, Hill Dale Co. Ltd., and Globus Stores Pvt Ltd.

**Industry Overview**

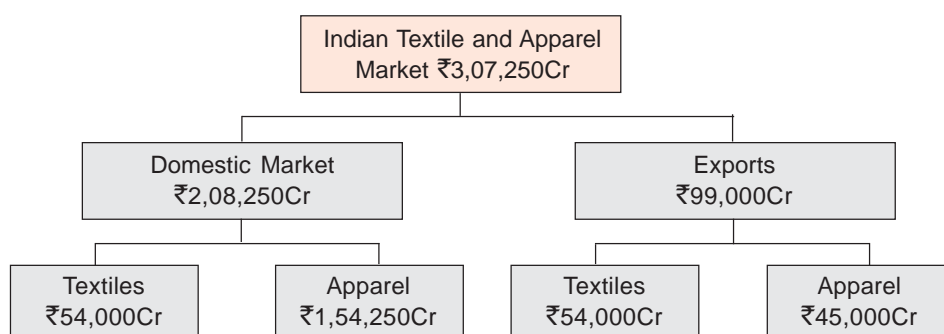
The global textile and apparel trade has grown at a decent pace by around 6% annually in the last two decades. There was some correction in the global textile and apparel trade in 2009 due to the global economic crisis resulting in slower growth. However the industry is recovering in 2010 and is expected to stabilize and grow further in future. With a positive outlook the industry has the potential to grow upto \$800bn by 2015.



Apparel constitutes the biggest category of global trade with 60% share. The EU and the US are the biggest destinations for apparel exports. The biggest exporting countries are China, India and Turkey. In recent years low cost countries like Bangladesh, Vietnam and Cambodia have also emerged as significant exporters of apparel.

## Textile and Apparel Market in India

Indian textiles and apparel industry is highly diversified and fragmented. The industry ranges from hand-spun and hand woven sector to capital intensive, sophisticated mill sector. In 2009, the total 'Indian Textile and Apparel market' was estimated to be ₹3,07,250Cr (\$67bn). In the last five years, the industry has grown at a rate of more than 10% annually. The industry is expected to grow at a much faster rate in the future, as it is fuelled by a strong domestic consumption, which is expected to remain robust despite the recent global economic downturn.



## Domestic Apparel Market

Currently the apparel retail market in India is estimated to be ₹1,54,250Cr (\$33bn). The market has grown at a CAGR of 18% in the last five years. The market even grew by 13% in 2009, which is in contrast to the negative trends seen in several countries. Apparel constitutes about 22% of India's modern retail market valued at ₹81,000Cr (\$18bn). The market is set to grow further with increasing presence of multinational players and also due to the increasing focus of Indian companies towards the domestic market.

With the global economy picking up and the faster growth prospects in India the domestic apparel industry is set to grow further and is estimated to touch ₹2,25,000Cr (~\$50bn) in the five years (growing at CAGR of 9%). The high growth of the industry offers substantial potential for new players to tap the inherent opportunities in the apparel sector. The categories having high opportunity include kids wear, women's western wear, innerwear and workwear.

## Indian Textile and Apparel Export

The total textile and apparel exports declined to ₹97,000Cr during 2008-09 from ₹1,01,000Cr during 2007-08, registering a fall of 4%. The main reason for decline in exports was the reduced global demand following the economic crisis, however the demand has picked up in 2009-10 and is expected to stabilize and grow further. This positive outlook is mainly driven by the following factors:

- Increase in domestic consumption and subsequent opportunity in new markets like China, Russia, Brazil
- Sourcing shift of buyers in US, EU and Japan from nearby countries towards lower cost countries in Asia

- Opportunity provided by sourcing shift of buyers from China.

India has also emerged as an attractive source destination in the past few years for many of the top global apparel retailers like GAP, Nautica, Target and M&S, who have their sourcing network in India. With a positive outlook, current exports of approx. ₹99,000Cr (\$22bn) could be expected to touch ₹4,50,000Cr (~\$100bn) in the next 25 years.

### Business Operations

Sudar Garments Ltd. (SGL) engaged in the manufacturing of garments for Men wear, Women wear and Kids wear. SGL operates as an integrated apparel manufacturer with the capability of designing and manufacturing involving cutting, body stitching, washing, ironing and finishing. It specializes in shirts, trousers and wide range of other apparel.

Until 2006-07, SGL had a small manufacturing set up, having 150 Sewing Machines and other supporting machines, under which each and every worker undertook independently the manufacturing of a garment. In order to bring efficiency into manufacturing, SGL undertook an expansion plan in the year 2007-08 to increase its to 5 Lacs garments by installing another 150 Sewing Machines along with few specialized supporting machines. The company introduced an assembly line approach for producing garments as is used by large apparel manufacturers. SGL's capacity was further increased in 2008-09 by installing 180 Sewing Machines and in 2009-10 by installing 116 Sewing Machines along with other balancing automatic specialized machines to produce 20 Lacs garments.

The manufacturing facility of SGL is setup at Raigad, Maharashtra with a built-up area of about, 29,626 Sq. Mtrs. having a combined capacity of producing 1,66,667 pieces of shirts, dress, pants tops, skirts, and denims per month. This unit caters to the requirement of whole sellers as well as own branded products through retail distribution network such as malls and multi branded outlets. The company is presently manufacture under its own brand name "Glory to Glory" and will be launching shortly two more brands namely 'St. Paul' and 'Majesty'. SGL has selling agents in South India for its existing brand 'Glory to Glory' and are rapidly consolidating its network.

### Product Details

SGL's product range includes:

Men's & Kids Wear (consists of Plain Shirts, Striped Shirts, Trousers, Casual Wear, Knit wear, Patchwork Shirts, Embroidery Shirts, Mix & Match Shirts, Denim, Cargos, etc.)

Women's Wear (consists of Ladies Shirts, Casual Wear, Knit wear, Tank Tops, etc.)

### Production & Capacity Utilization

Capacity utilization for the last three financial years:

| Period | Actual Production (Pcs.) | Installed Capacity (Pcs.) |
|--------|--------------------------|---------------------------|
| FY08   | 3,18,500                 | 5,00,000                  |
| FY09   | 6,52,000                 | 8,00,000                  |
| FY10   | 18,88,500                | 20,00,000                 |

## Future capacity utilization over the next three years:

| Period | Estimated Production (Pcs.) | Installed Capacity (Pcs.) |
|--------|-----------------------------|---------------------------|
| FY11   | 30,00,000                   | 30,00,000                 |
| FY12   | 40,05,000                   | 45,00,000                 |
| FY13   | 40,56,750                   | 45,00,000                 |

## Strengths

### Understanding the consumer

The management of SGL has wide experience in the field of apparel manufacturing, which helps the company to understand the consumer preference in a better way. This strength enables SGL to cope up with emerging new trend in the market.

### In-house integrated unit

SGL's core competency lies in its in-house manufacturing and embroidery skills. Right from sourcing the raw material to manufacturing which includes, dyeing, and washing of the readymade garments is carried out in-house including packaging and dispatching of finished goods. The packaging and dispatching of the products is also carried out in-house, which enables SGL to stream line its inventory management and production process thereby attaining optimum utilization of installed capacity and help in controlling inventory and production process. In-house integration helps SGL to keep its cost low which eventually helps the company in maintaining healthy margins.

### Efficient supply chain management

SGL procure its raw material directly from fabric manufacturers and authorized distributors based on its requirements. The company follows ERP process, an advance logistic system, which enables it to control inventory. This also helps the company in effectively servicing the requirements of its distributor and multi brand outlet.

### Distribution network

SGL's distribution network span over metros, mini metros and large cities in major parts of the South India The company distribute its products to major selling agents.

### Technology

SGL use latest technology and machinery procured from major suppliers/distributors in India. These modern machineries help SGL in maintaining high quality standards, enables radical design and innovation in creating new look and new trends. Latest technology has also helped the company in rolling out new combination like jeans crafted to look old, rock blast, bleach wash, wrinkle free, etc.

### Strong Customer Base

SGL have strong customer base in the domestic market. Over a period of time, the company has built-up a track record for quality products and timely delivery. SGL has been able to retain customers and further strengthen the relationship by providing them timely and cost competitive solutions for their requirements. The company intends to leverage on these customer relations developed by it for its existing as well as proposed expansion project.

### Management team

SGL has a strong management team with many years of experience in the apparel industry, which helps in taking appropriate decisions. The company has a team with industry specific knowledge in activities like cutting, stitching, washing and finishing for carrying out the day to day operations. Regular training of managerial and supervisory staff in their respective jobs help the company to maintain efficiency.

### Objects of the Issue

The objects of the issue are:

- Expansion of the existing apparel manufacturing unit
- Meeting Working Capital Requirement
- Setting up Retail Outlets and Brand Building
- Meeting General Corporate Expenses
- Meeting the Issue Expenses

### Utilisation of Net Proceeds

| Particulars  | Amount (₹Cr) |
|--|--------------|
| Expansion of the existing apparel manufacturing unit | 26.29        |
| Meeting Working Capital Requirement                  | 27.30        |
| Setting up Retail Outlets and Brand Building         | 5.90         |
| Meeting General Corporate Expenses*                  | 6.00         |
| Meeting the Issue Expenses                           | [•]          |
| <b>TOTAL</b>   | <b>[•]</b>   |

### Investment Risks

(Please refer to the RHP for a complete listing of risk factors)

- SGL's operations are subject to high working capital requirements. The inability to maintain sufficient cash flow, credit facilities and other sources of funding in a timely manner, or at all, to meet requirement of working capital or pay out debts, could adversely affect its operations.
- CRISIL Limited has assigned an "IPO Grade 1" indicating poor fundamentals, to SGL's proposed initial public offering. The IPO grading report of CRISIL mentions the weaknesses as:
  - a) Inexperienced and new management
  - b) Intense competition & rising raw material prices, exert pressure on margins
  - c) Dependence on contract labour
  - d) Heavy dependence on few buyers
  - e) Lack of long term export contract
  - f) Retail foray to exert pressure on financials
  - g) Independent director involved in key strategic & financial decision

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- Fully equity expansion without the support from the promoters.
- SGL require a number of statutory and regulatory permits and licenses to operate its business and any delay or inability to obtain or renew the same in a timely manner may have an adverse impact on its business.
- SGL derive a significant portion of its revenue from a few customers and any loss of one or more customers or a reduction in their demand for its products and services could adversely affect its business, financial condition and result of operations.
- There has been significant increase in the amount of receivables due to increase in credit sales between FY08 and FY10. Any non-receipt or delay in receipt from debtors may affect the operations and profitability of SGL.

### Restated Profit & Loss Statements

(₹Cr)

| Year/Period ended on                       | 31-Mar-06 | 31-Mar-07 | 31-Mar-08 | 31-Mar-09 | 31-Mar-10 | 30-Sep-10 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|
| <b>Income</b>                              |           |           |           |           |           |           |
| Sales of Products Manufactured             | 5.83      | 7.88      | 8.68      | 20.67     | 52.76     | 49.26     |
| <b>Net Sales</b>                           | 5.83      | 7.88      | 8.68      | 20.67     | 52.76     | 49.26     |
| Other Income                               | 0.00      | 0.06      | 0.00      | 0.02      | 0.01      | 0.00      |
| Increase/(Decrease) in Inventories         | 0.47      | 0.69      | 0.21      | 0.21      | 1.21      | 3.34      |
| <b>TOTAL(A)</b>                            | 6.31      | 8.63      | 8.89      | 20.90     | 53.97     | 52.60     |
| <b>Expenditure</b>                         |           |           |           |           |           |           |
| Materials Purchase                         | 2.81      | 5.55      | 5.30      | 13.90     | 36.57     | 36.55     |
| Other manufacturing expenses               | 2.97      | 2.30      | 1.89      | 3.40      | 7.40      | 4.68      |
| Employees Cost                             | 0.09      | 0.13      | 0.14      | 0.43      | 0.65      | 0.54      |
| Administrative Cost                        | 0.10      | 0.08      | 0.27      | 0.15      | 0.31      | 1.06      |
| Selling and distribution Cost              | 0.01      | 0.03      | 0.02      | 0.03      | 0.08      | 0.17      |
| <b>TOTAL(B)</b>                            | 5.98      | 8.09      | 7.62      | 17.91     | 45.00     | 43.00     |
| Profit Before Interest, Depr. & Tax (A+B)  | 0.32      | 0.54      | 1.27      | 2.99      | 8.98      | 9.60      |
| Depreciation                               | 0.10      | 0.10      | 0.25      | 0.49      | 1.06      | 1.53      |
| Profit Before Interest and Tax             | 0.23      | 0.44      | 1.02      | 2.50      | 7.92      | 8.07      |
| Financial Charges                          | 0.19      | 0.24      | 0.65      | 1.60      | 1.61      | 2.07      |
| Profit after Interest and Before Tax       | 0.04      | 0.20      | 0.37      | 0.90      | 6.30      | 6.00      |
| Profit before Taxation                     | 0.04      | 0.20      | 0.37      | 0.90      | 6.30      | 6.00      |
| Provision for Taxation                     | 0.05      | 0.09      | 0.09      | 0.31      | 1.81      | 1.82      |
| Provision for Deferred Tax                 | 0.00      | 0.00      | 0.00      | 0.00      | 0.38      | 0.10      |
| Total                                      | 0.05      | 0.10      | 0.09      | 0.31      | 2.19      | 1.92      |
| <b>PAT but Before Extra ordinary Items</b> | 0.01      | 0.11      | 0.28      | 0.59      | 4.11      | 4.08      |
| <b>Net Profit after adjustments</b>        | -0.01     | 0.11      | 0.28      | 0.59      | 4.11      | 4.08      |
| Weighted average number of shares          | 2150000   | 2150000   | 4051598   | 4494875   | 4522076   | 9458975   |
| EBITDA margin (%) on Net Sales             | 5.56%     | 6.85%     | 14.64%    | 14.46%    | 17.01%    | 19.49%    |
| EPS (₹)                                    | -0.04     | 0.49      | 0.68      | 1.31      | 9.09      | 4.31      |
| Book Value (₹)                             | 12.74     | 15.18     | 52.07     | 58.61     | 20.41     | 24.7      |

## Restated Balance Sheets

(₹Cr)

| Year/Period ended on                       | 31-Mar-06 | 31-Mar-07 | 31-Mar-08 | 31-Mar-09 | 31-Mar-10 | 30-Sep-10 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|
| <b>Fixed Assets</b>                        |           |           |           |           |           |           |
| Gross block                                | 1.01      | 1.01      | 5.12      | 5.12      | 28.63     | 28.87     |
| Less: Depreciation                         | 0.28      | 0.39      | 0.64      | 1.13      | 2.19      | 3.64      |
| <b>NET BLOCK</b>                           | 0.73      | 0.63      | 4.48      | 3.99      | 26.44     | 25.23     |
| Capital Work-in-Progress                   | 0.00      | 0.00      | 5.41      | 13.60     | 1.20      | 6.49      |
| <b>TOTAL- FIXED ASSETS (A)</b>             | 0.73      | 0.63      | 9.89      | 17.59     | 27.64     | 31.72     |
| <b>Investments (B)</b>                     | 0.01      | 0.01      | 0.01      | 0.24      | 3.48      | 3.67      |
| <b>Current Assets, Loans and Advances:</b> |           |           |           |           |           |           |
| Inventories                                | 0.67      | 1.36      | 1.57      | 1.78      | 2.98      | 6.33      |
| Receivables                                | 0.91      | 2.07      | 3.14      | 4.84      | 20.94     | 30.07     |
| Cash and bank balances                     | 0.01      | 0.00      | 0.01      | 0.02      | 3.31      | 0.56      |
| Loans and advances                         | 0.09      | 0.05      | 0.22      | 0.23      | 0.07      | 0.15      |
| Other Current Assets                       | 0.07      | 0.07      | 0.11      | 0.15      | 0.23      | 0.23      |
| <b>TOTAL(C)</b>                            | 1.76      | 3.56      | 5.05      | 7.01      | 27.54     | 37.33     |
| <b>TOTAL ASSETS (A + B + C)</b>            | 2.49      | 4.20      | 14.94     | 24.84     | 58.66     | 72.72     |
| <b>Liabilities and provisions</b>          |           |           |           |           |           |           |
| Secured loans                              | 1.69      | 2.47      | 9.54      | 14.32     | 25.43     | 33.64     |
| Unsecured loans                            | 0.17      | 0.84      | 0.03      | 2.63      | 3.63      | 2.62      |
| Deferred Tax Liability                     | 0.00      | 0.00      | 0.00      | 0.00      | 0.38      | 0.48      |
| Current liabilities                        | 0.04      | 0.13      | 0.58      | 0.68      | 8.07      | 9.42      |
| Provisions                                 | 0.06      | 0.11      | 0.11      | 0.34      | 1.84      | 3.18      |
| Share Application Money                    | 0.00      | 0.00      | 0.00      | 1.59      | 0.00      | 0.00      |
| <b>TOTAL Liabilities (D)</b>               | 1.95      | 3.54      | 10.26     | 19.57     | 39.35     | 49.34     |
| <b>Net worth (A+B+C-D)</b>                 | 0.55      | 0.65      | 4.68      | 5.27      | 19.31     | 23.39     |
| <b>Represented by</b>                      |           |           |           |           |           |           |
| Share capital                              |           |           |           |           |           |           |
| Equity Share Capital                       | 0.43      | 0.43      | 0.90      | 0.90      | 9.46      | 9.46      |
| <b>TOTAL(A)</b>                            | 0.43      | 0.43      | 0.90      | 0.90      | 9.46      | 9.46      |
| Reserves and surplus                       | 0.12      | 0.22      | 3.78      | 4.37      | 9.85      | 13.93     |
| <b>TOTAL(B)</b>                            | 0.12      | 0.22      | 3.78      | 4.37      | 9.85      | 13.93     |
| <b>Net Worth (A+B-C)</b>                   | 0.55      | 0.65      | 4.68      | 5.27      | 19.31     | 23.39     |

**Keynote Capitals Ltd.**

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